Volume 2 Number 11

November 2004

Blue Collar Investment Advisor

BCIA

Wall Street

- DJ 10522
- S&P 500 1183
- NASDAQ 2102

Inside this issue:

Behavioral Finance 1

Watch List 4

BCIA Portfolio 5

Returns 6

Q3 Earnings 7

Behavioral Finance

This is part one of a three part article. This article will help explain another piece of our investment philosophy as we explore the topic of behavioral finance.

Behavioral Finance is a rather new discipline in the field of finance and economics. It borrows from psychology, sociology, physics and political science to better explain the action of the supposed rational actors in modern finance. The field received its start with the research of Daniel Kahneman, Princeton University and the late Amos Tversky in the mid 1970's with their pioneering research on decision making and cognitive theory. The voluminous research of this pair over the years has provided the underpinnings of the Behavioral finance movement. Much of the progress in the field has been made since the mid 1980's. Along the way much controversy has been generated. Behavioral finance is presented in direct contrast to much of modern finance. The behaviorists contend that the assumptions that modern finance is based on are flawed. They maintain that markets are not efficient and actors are not rational. As Statman suggests standard finance people are modeled as rational. Behavioral finance people are modeled as normal. (Throughout this article we will use the term standard finance and modern finance interchangeably.) This distinction between normal and rational (in the modern finance sense) allows for the "irrationality" that is often displayed by market participants.

A hammer does not solve every home improvement problem

While behavioral finance has disproved much of modern finance they have not been able to develop a unifying theory of their own. This we welcome. As Charlie Munger of Berkshire Hathaway says, "To the man with only a hammer, every problem looks pretty much like a nail". The tool of choice for the economist is the theoretical model. Just as in the hammer's case, equations cannot be expected to solve every problem in finance. In our view it is arrogant to even suggest that a unifying model can be developed for something as dynamic as economic markets. Check over in the physics department for progress on a unifying model. The attempts by standard finance have been woefully inadequate at predicting actual market behavior. Behavioral finance does a great service by highlighting the areas were we may be susceptible to error in hope that we can avoid making some of them. However, as with many other facets of life, markets are uncertain. The most prominent of the economist's tools has not provided a solution and will continue to prove inadequate. Behavioral finance has added a few new tools to the arsenal. With these tools the view of markets has been altered and the acceptance is growing.

Behavioral Finance cont.

Stock and Business' are related as parts to a whole.

Before we begin with our discussion of behavioral finance proper, we will disclose our concepts of risk and asset valuation to highlight our bias. This bias will color the lens through which we examine behavioral finance and affect how we relate it to modern finance. Our leaning towards behavioral finance concepts is consistent with the "us versus them" nature of the two competing views of finance.

We have views that do not align specifically with either of the two branches. With this said our view shares many of the underlying principles of behavioral finance and this is how we will begin our discussion.

One of the major shortcomings of modern finance is the disassociation of stocks from the company and assets underlying them. This fallacious line of thought leads to the use of price as a measure of volatility. There is no consideration of the factors underlying the determination of price. Consider the concept of price being compared to jumping over a 1000 foot cliff. Jump over and the fall can be rather violent at the terminus. If we attached a bungee jumping cable that let you fall only 999 feet the distance dropped would be similar but the outcome would be vastly different due to the different factors affecting the two jumps. If someone reacted solely to the information that you jumped over a cliff they may not reach the correct conclusion. To base your assessment of an investment's risk blindly on price movement without consideration of the underlying reason(s) for that movement is senseless. Stock prices routinely vary over a 50% range during the course of a year. This volatility is more than the modern finance predicts. There are other variables that causes security prices to change. Risk is one dimensional in modern finance, not real life.

The modern finance theory of risk assumes price to be the important factor in determining risk. In the real world risk is multi factored. To make the assumption that it can be diluted down into one generic finance defined risk is absurd. Risk is affected by participant's values and psychological makeup. This article maintains that risk exists in the form of information risk, period based risk, and behavioral/cognitive based risk. The modern finance assumption of risk has been used for so long that many have forgotten that it is just an assumption. The assumption was meant to be a convenience and roughly representational of risk. It has served its first role admirably and failed miserably in the second. We will define informational risk as the risk associated with the ability to gather useful information that can be used to gain useful insight into factors that may affect the value of a security. Period based risk highlights the idea that risk factors may change based on the holding period of an investment. To describe risk for an investment that is to be held for a month is much different than the risk factors for an investment that is being held for five years. An investment held for a short time period will be much more susceptible to price changes from any single piece of information. Behavioral/cognitive risk is the ability of the actor to filter out useful information and interpret it correctly.

We also question the usefulness of basing a model on rational actors which assumes that someone can describe what behavior is rational. Many people buy lottery tickets which is termed irrational in modern economics. Is everyone irrational when the majority of people participate in an act that qualifies as irrational in modern economics terms? Maybe it is the definition of rational that is wrong. The point is there is no way to distinguish what is rational and what is irrational. It all comes back to the reasons. If people get enjoyment from purchasing lottery tickets, how can it be

Behavioral Finance cont.

called irrational? Modern finance removes any value expressive actions from finance theory. Logically it can not be done if you want an accurate model.

Humans tend to naturally select activities that are efficient. The human body has an affinity for natural self selection of energy conserving activities in its attempt to remain in homeostasis. When you walk you clear the ground by a little more than one half of a centimeter. This explains in part why it is so easy to stumble. Your body does this because it strives to conserves energy. This ability of humans to self select efficient means of action may have more influence on the concept of "rationality" than the modern finance definition of rationality takes into account. To automatically assume that people are irrational because they do not meet the economic ideal of expected utility is making the leap that the ideal is correct and not the human. Kahneman and Tversky have done much to discredit the theory of expected utility. This is another area where modern finance has relied on faulty premises.

> *Behavioral finance has been fatally attracted to the myth that science, is methodology, its methods, its definitions, etc. are just what modern finance says they are and that "rational" behavior is what practitioners ought to be doing even if it is not what they are doing now.*

Over the long term the earnings that are thrown (no pun intended) off by an asset determine its price. When determining an asset's value in accounting it is commonly done by valuing the future stream of cash inflows. In this regard stocks can be treated as having some similar attributes in common with bonds. This method also can be applied to whole companies. The predictability of future cash flows will vary by the company and the ability of the predictor. Some companies are inherently more predictable. An example is Landauer a company that provides consumable medical devices and has a majority market share. Customers are forced to be repeat customers due to the regulation in the industry. With this steady stream of repeat customers revenue climbs at a fairly predictable rate. The skill of the predictor will also vary with specific knowledge and experience playing key roles.

It is often helpful to think of the local 7-11 when determining the value of a company. How would you value your local 7-11 without any publicly traded shares? One common method is by discounting future cash flows. By no means is this meant to be a definitive measure of a business' worth. It serves as a great starting point to consider how the price of the business compares to its value. There are other factors that will play a role in the value of a business like the demand for businesses of this type. It is unlikely the price that the local 7-11 commands will vary by 50% over the course of the year as do common stocks on average. Business values in private markets rarely reflect this sort of price variance. We contend that the true base measure of volatility is earnings and the prospect of future earnings. This eventually came true for the dotcoms no matter what their expected return was according to modern finance. You will not gain or lose any money in your account by changes in earnings; only changes in share price will do that. Without earnings (positive or negative) you have no share price. In the short term stock prices can vary widely, over the long haul they correlate with earnings. As Ben Graham was fond of saying "In the short term the market is a voting machine, in the long term it is a weighing machine."

As we stated before cash flows are not always easy to predict. Difficulty in predicting cash flows will cause share prices to be volatile. This volatility is not to be confused with risk. With markets full of not quite modern finance defined rational actors, psychological factors add fuel to this volatility. We intend to show that these factors expose a frailty of the human condition that can verge on embarrassing. Nobody can escape these hard wired pathways that generate such embarrassing results including young school children to economic researchers.

Continued Next Month.

Watch List

Several companies have had substantial increases in their share price since we last talked. Altria has risen over $10 per share, Allergan over $9, St. Joe over $8, and The Wahington Post over $60. All of these companies are that much more unreachable for us. We would have been much more satisfied with a similar size move in the opposite direction. As quickly as we fell in love with Web MD we have lost our interest. We have found competitors that do the same thing better.

When prices rise like they have recently our job becomes much tougher. We have found another small company that we are investigating. The company, CFC International, manufactures plastic laminates that are used in, among other applications, credit card holograms. You can check out their web site at this address. www.cfcintl.com.

Company	Current	P/E	52 Week	52 Week	Estimated '04	Dividend
	price		High	Low	EPS	Yield
Altria Group, Inc./MO	$58.16	12.2	$58.96	$39.60	$4.77	5.00%
Allergan/AGN	$79.02	28.8	$92.61	$68.59	$2.74	0.50%
Bioanalytical Systems, Inc./BASI	$5.40	n/a	$6.23	$3.40	n/a	n/a
Genentech, Inc./DNA	$48.72	57.8	$68.25	$38.15	$0.81	n/a
Gentex Corporation/GNTX	$32.36	23.0	$47.08	$32.00	$1.46	1.90%
The St. Joe Co./JOE	$56.34	53.6	$56.99	$31.10	$1.02	0.20%
Landauer, Inc./LDR	$46.48	21.4	$50.30	$35.08	$2.03	3.70%
Paychex, Inc./PAYX	$33.46	35.6	$40.54	$28.83	$0.94	1.60%
QLT Inc./QLTI	$15.70	17.8	$30.70	$13.18	$0.85	n/a
Sanderson Farms/SAFM	$36.63	8.0	$55.18	$19.70	$5.12	1.10%
Tejon Ranch Co./TRC	$39.11	n/a	$43.21	$30.70	$0.00	n/a
USG Corporation/USG	$31.17	4.4	$20.17	$12.30	$6.09	n/a
TheWashington Post Co. /WPO	$950.75	27.5	$983.50	$654.00	$34.67	0.70%

Subscription Information

To subscribe to the Blue Collar Investment Advisor visit our web site at www.ebcia.com. Click on the subscribe link to enter your subscription. Or, you can contact us at subscribe@ebcia.com. A subscription cost $95 for 12 monthly issues. We feel very confident that we can easily justify your subscription cost by helping you beat the market averages.

The BCIA Portfolio

Company	Porfolio Percentage	Current price	Buy Price (less than)	P/E	Dividend Yield
Amgen/AMGN	**4.50%**	**$55.22**	**$60.00**	**22.4**	**n/a**
Astronics Corporation/ATRO	**4.60%**	**$4.88**	**$5.15**	**71.4**	**n/a**
Berkshire Hathaway B/BRK.B	**14.60%**	**$2,837.00**	**$3,050.00**	**n/a**	**n/a**
Cash	**10.30%**	**$1.00**	**n/a**	**n/a**	**n/a**
Cell Genesys, Inc./CEGE	**4.70%**	**$6.58**	**$9.00**	**n/a**	**n/a**
Consolidated-Tomoka Land Co./CTO	**24.80%**	**$36.17**	**$36.00**	**16.9**	**0.80%**
Kensey Nash/KNSY	**2.30%**	**$30.70**	**$26.50**	**24.8**	**n/a**
ModPac/MPAC	**9.50%**	**$11.14**	**$10.20**	**17.2**	**n/a**
OMI Corporation/OMM	**23.30%**	**$16.51**	**$16.90**	**7.3**	**1.30%**
Protein Design Labs/PDLI	**1.4%**	**$18.00**	**$18.75**	**n/a**	**n/a**

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.

Again OMI has been our dominant performer the past month for the third month in a row. You may see this statement again the next several months. Shipping rates are up around $130k per day (for suezmax ships) and the company has a break even of $10k per day. This adds up to huge profits. The company will earn well over $100 million this quarter. This will be more than the company has earned in any previous year.

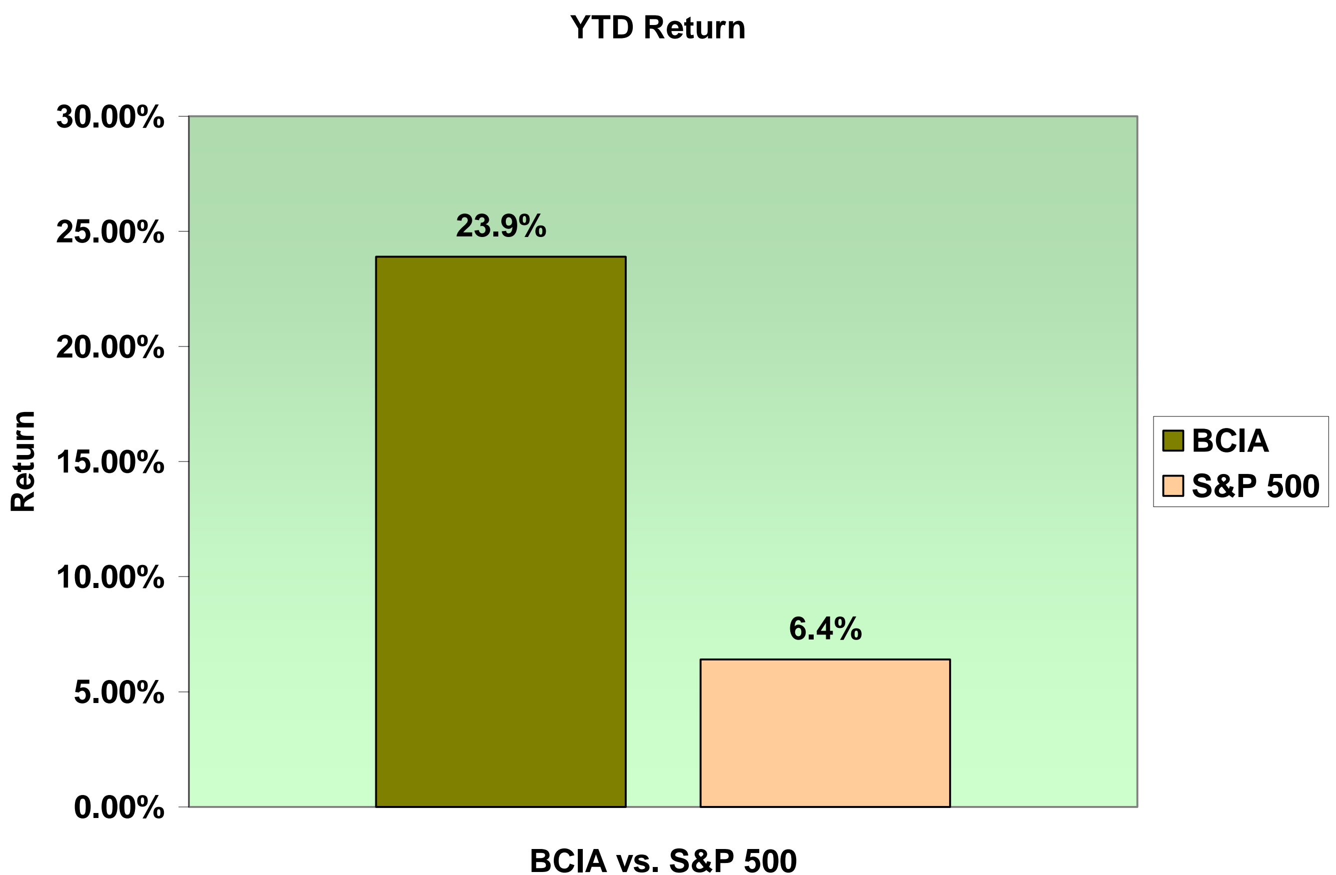
We have increased the number of shares of Cell Genesys in our portfolio and have not announced it to our subscribers. We have added shares in order to sell an equal number of shares at the end of December to take advantage of the tax loss. The long term prospects of the company are still enticing. Our first shares were purchased in 1999 at prices similar to what the company is selling for now. Unfortunately we made some real stupid decisions to purchase shares at prices as high as $22 per share. This story is a long an painful one. The price of the companies shares have sold for as much as $61 dollars per share over this time frame. All the while we refused to sell to avoid repeating a previous mistake. In the future we probably not be buying any biotech companies with early stage products. We had a complete failure in our ability to project cash burn rates. The management also bungled an opportunity to generate huge amounts of cash through the sale of securities they have held for as precipitous a drop as we have experienced.

Fortunately Cell Genesys has always been a small portion of our portfolio. On the bright side the share are about as low as they can go without major problems. The company could have a product approved for sale sometime in the next two years. This would erase a lot of the pain of holding for six years to see that share price dead even with where it began.

Returns

The last month we have seen our portfolio skyrocket. We now have nice 23.9% return for the year to date and have outperformed the S&P 500 index by 17.5% percentage points. Much of this has been due to the returns of three of our holdings. OMI, ModPac and Consolidated Tomoka are all enjoying healthy returns this year. Consolidated Tomoka is up 20.2% from the beginning of the year. ModPac is up 22.8% since our July recommendation. OMI is up 127% so far this year. Our other significant holding, Berkshire Hathaway is flat for the year. Things have gone about as well as we could have hoped for this year. If these numbers hold at the end of the year it will mark the fifth straight year we have outperformed the S&P 500 average.

These results will be tough to top next year. We are sure that next year will bring some surprises an unexpected events just as this year has.



Q3 Earnings

We had a nice third quarter earnings season. Many of our companies had good news to report.

Amgen- Amgen had another great quarter with sales increasing 23% and operating earnings climbing 21%. The company raised their sales and earnings guidance for 2004. Sales of Aranesp their second generation anemia drug increased 39% to $608 million this past quarter. Arthritis drug Enbrel showed an increase in sales of 45% to $496 million from the third quarter of last year. Amgen has performed spectacularly this year. Their stock price has barely budged. We are very comfortable holding them at this price and expect to be rewarded in the near future for our patience.

Astronics- Net sales increased 11% in the third quarter compared to last years third quarter. This quarters net loss increased to $.05 per share from $.04 per share in last years third quarter. We have finally turned the corner and should see a much more positive picture next year. The company reported that their backlog increased to $25.6 million an increase of $8.6 million from last years third quarter. The increased backlog should lead to higher earnings in 2006. The company has said they expect a 20% increase in earnings next year. The share price should tag along.

Berkshire Hathaway- Berkshire is doing what it does best, generating tons of cash. They have done this so well in the past few years, combined with the difficulty they have had employing it, has led to huge increases in the cash on the books. At the end of the third quarter the company had more than $42 billion in their cash account. They also have more than $60 billion dollars in investments on their balance sheet. The company generated $5.5 billion in cash from operations in the third quarter. The company had earnings of $1.1 billion. This was accomplished in spite of a $816 million dollar loss in their insurance business' due to claims relating to the four hurricanes that struck Florida. Overall it was a fine quarter considering the insurance losses. In the insurance business occasionally large loss events will occur. Four major hurricanes in one year is not an everyday occurrence. These results will be evened out by nice profits in the next few quarters. Disasters and the associated losses are always great justification to raise rates.

Cell Genesys- Revenues were a paltry $3.2 million and losses were a healthy $24 million. The company finally moved a product into phase 3 clinical trials. They are enrolling patients for their GVAX prostrate cancer vaccine which will hopefully lead to FDA approval in 2007. Several other candidates are in phase 2 trials with the possibility of one or more entering phase three trials next year. The company's web site has a nice little video that shows how their vaccines are designed to work. The company has cash and investments totaling $207 million dollars to support them until they can bring a product to market. If they can successfully get FDA approval the share price will skyrocket. Patience will be needed with this issue. We sure wish we were buying this issue for the first time instead of being owners for the past 6 years.

Consolidated Tomoka- CTO had rather unspectacular results this past quarter. The company earned $700k or $.13 per share. The company now has $60 million in income properties generating earnings for them. The biggest news came after the close of the third quarter. CTO announced the closing an $18 million land sale that will ensure big

Q3 Earnings

earnings next quarter. Management reiterated their commitment to concentrating on closing their backlog of land sale contracts. Another couple of closings in the 4th quarter and the earnings numbers will be so large that they will verge on ridiculous. The share price is virtually certain to follow.

Kensey Nash- KNSY reported earnings of $.26 per share a 44% increase over last years first quarter. Yes, first quarter. The company has a fiscal year end of September 30th. Sales were up 22% over the same quarter last year. The company also announced that they anticipate approval of their TriActiv device near the end of 2004. This will be an exciting opportunity that could signal sharply rising profits over the next 3 to 5 years. The company has only three analysts that follow it and does not garner a lot of attention. This will begin to change if they get approval for TriActiv.

OMI continues its strong earnings growth.

Mod-Pac- Mod-Pac had a solid quarter with a 20% increase in sales and a 13% increase in earnings. The company reported earnings of $.23 per share. This reflects the first months worth of earnings resulting from the $20 million payment from Vista Print. Next quarters earnings are sure to top $.40 per share. Subsequent to the end of the quarter Mod-Pac reported that they uncovered problems with previous periods accounting. This is a very disturbing revelation and one we are monitoring very closely. The net result of this fiasco was that the company announced appropriately that their previous two quarterly reported from this year and their year 2003 report cannot be relied upon. These reports will be amended and refilled with the SEC. Until then all we have is a lot of questions. We have no guarantee that the strong earnings they have reported will survive this restatement. The worst scenario would be that these problems result from fraud instead of errors. Our thinking right now is that the company had little to lie about and was just negligent. We will notify you if any action is required.

OMI- We are running out of upbeat adjectives to describe OMI's performance. This quarter was amazing. Net income increase 368% over last years third quarter. The company earned $50.5 million on revenue of $127.8 million. The result was net profit margins exceeding 39%. Tanker rates for the suezmax ships that the company operates have soared to over $130k per day. The company has a breakeven of a little under $10k per day. Rates could spend an extended time over $300k per day if we have a cold winter or weather in the shipping lanes iare poor. Earnings are going to be unbelievable. Third quarter earnings were great and the fourth quarter could easily be twice as high. Earnings should come in over $100 million this next quarter and may be even higher in the first quarter of 2005. Plenty more good news to come.

Protein Design Labs- PDLI narrowed its loss to $.14 per share from a loss of $.20 per share in last years third quarter. Total revenues more than doubled from $9.3 million to $19.8 million over the same time. Royalty revenues have increased dramatically as more products using the company's technology receive FDA approval. In the past week another product that Elan and Biogen have developed using PDLI's technology has been approved by the FDA. The company upped their year end revenue guidance. This company is in great shape going forward.

100 Burgundy Terrace Amherst, New York 14228