

FACT OR FICTION

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Who said daytime television is boring? For pure viewing entertainment look no further than a financial news station. It has drama, action, comedy and a diverse cast of characters. The original concepts for these stations however, was to be informational, an aid to individual investors. Their concept of "thorough analysis and coverage," of our nations new favorite pastime has turned into a lesson in anarchy. The daily lineups of analysts with their expert opinions are cast with the intent that they will aid the individual investor. The fact of the matter is they do nothing of the sort. If an individual wants to be entirely confused on what to do with his or her nest egg they should tune right in to one of the financial news stations. The opinions from analysts all over the street are extremely fickle, changing with at the drop of a hat. One "expert" states that the sky is falling; the next is declaring "Dow 20,000." In an effort to make a little sense out of the seesaw that we have been witnessing the past few months, I'm going to leave my readers with some... "Believe it or not," facts.

A question frequently raised by investors tends to lead to the worst-case scenario. In other words, "Where is the bottom.?" Steve Leuthold owner of the research firm The Leuthold Group used 41 years of market statistics to see where the Dow Jones Industrial Average, and the Standard & Poor's 500 Index would land if the markets returned to what he states are "normalized" values. His math was done by calculating historical levels of P/E ratios, dividend yields, price-to-book-value ratios, and a ratio of market value to gross domestic product. He then put these values to two tests. First, where the values would be if the stocks fell to median value, and second, where they would be if values were in a bear market. The answer...Dow 4937 or Dow 3949. Never say never!

Myth: When the Federal Reserve lowers interest rates, it always makes stocks go higher and will forestall any economic recession. True, when the Fed lowered rates three weeks ago the stock market has rallied. The bond market on the other hand is not so sure. Gretchen Morgenson from The New York Times reports that the bond markets are gripped by catalepsy. A credit crisis could start there. The difference between the yields demanded on junk bonds and those paid by Treasury securities with like maturation dates is known as the spread. When investors embrace risk, spreads between Treasury issues and more speculative debt are narrow. When investors buy riskier bonds their price will rise and yield will decline. When investors avoid these bonds the opposite occurs. Even with the Fed lowering rates, the spreads remain very wide by historical standards. Ned Riley of BankBoston Corporation states, "This spread reflects that the economic environment is not exactly very healthy." Stock investors are still hoping that the Fed will reduce rates another half point on November 17. Even if they do, how healthy is a market that needs the Fed to reduce rates to keep the bull alive. It is artificial strength and will only last so long. J. Alfred Broaddus, president of the Federal Reserve Bank of Richmond stated that the risk that the economy's growth could accelerate had vanished. He went on to state "the Fed, cannot, be held hostage to the markets on interest rate policy".

One of the tools economists use to track the movement of the economy is the Leading Economic Indicators. These indicators precede the upward and downward movements of the business cycle. They may also be used to predict the near term activity of the economy. The Conference Board's Composite Index of Leading Economic Indicators held steady in September for the second straight month. Michael Boldin, Director of Business Cycle Research at the Conference Board states, "For two straight months the leading indicators have languished, which means the economy will be hard-pressed to match the robust growth posted the past few years." The most interesting thing about the eleven leading indicators were the ones that performed poorly. Five components of the leading index fell, while four rose, and one held steady. The largest

decreases just so happened to be indicators that reflect the health of the stock market. The most significant decreases were stock prices, interest rate spread, and building permits.

Some other facts to consider while taking a look at your portfolio. One of Japan's largest banks has applied for bailout with others soon to follow. In the United States, Chase Manhattan, Bankers Trust, Citigroup, J.P. Morgan, and BankAmerica all reported big earnings hits because of the global economic crisis. In fact, according to U.S. News and World Report, Bankers Trust's losses were so huge that it's now considered a takeover target by Deutsche Bank. BankAmerica's 900 million-dollar losses forced President David Coulter to resign. Investment banking operations on Wall Street have virtually grounded to a halt. Goldman Sachs, which was about to end its partnership and go public, shelved the deal and added 57 new partners. Merrill Lynch and J.P. Morgan just announced layoffs with more firms expected to follow. Financial panic may be over in Asia, but its problems have not gone away. Most importantly is the fact that share prices in the United States remain substantially overvalued.

Many analysts would like you to believe that recent drops in bond yields and the expectation of further falls in interest rates justify you buying more stock. The Economist states that the main reason bond yields and interest rates have come down is concern about financial turmoil and a growing risk of recession. What that points to is shrinking corporate profits. Shrinking profits is not good for share prices. The most interesting thing is that while equity analysts talk up share prices on television, economists often employed by the same firm are becoming bearish on world growth. According to The Economist, the world economy is supposed to expand by less than 1.5% next year. By past standards that is a recession. Folks, I think it is time to take off those rose colored glasses.