

January 2000

YEAR 2000 — REALITY RECONNECT

1999 was both bull and bear. If we look at the “averages”, it was a bull market. If we look at the average stock, it was a bear market. Actually, it was a very strange year in which everything rational and common sense was upside down. How strange was it? Consider that if you owned only companies that made profits, those stocks declined on average 2% for the year. If you bought only companies that lost money, those stocks went up on average 50%! It was an upside down situation. It was really a year in which speculation and gambling paid off, while using prudent time-honored value criteria to invest did not pay off. Do we think this new era of investing is the “New Paradigm”? Absolutely not! In the long run, there is a connection between earnings and price performance.

This is Crazy!

**1999
Fundamentals
Did Not Matter**

	AVG. RETURN
Stock <u>with</u> earnings	- 2%
Stocks <u>without</u> earnings	+ 50%

So, while it was not easy to watch all the money made by gamblers and speculators in new public offerings, internet stocks, and overvalued technology issues, the situation is setting up an incredible opportunity for conservative value investors. Consider price earnings ratios (P/Es). A low P/E theoretically suggests that an investor will have their capital investment returned in a shorter time than an investor who buys stocks with high P/Es. Another way to look at P/Es is to think of it as people’s expectations. High P/E equals high expectation. The problem with high expectations today is that they are absurd in the technology and big cap sectors, and if those

A Comparison of Value

	PRICE/EARNINGS RATIO
NASDAQ Index Technology	200
S & P 500 Index Big Cap	33
ValueLine Index Average Stock	14

**The Values are Not in Technology
or Big Cap Stocks.**

High P/E equals high expectation. The problem with high expectations today is that they are absurd in the technology and big cap sectors, and if those expectations are not met, look out! On the other hand, value stocks have low expectations and therein is the low risk opportunity.

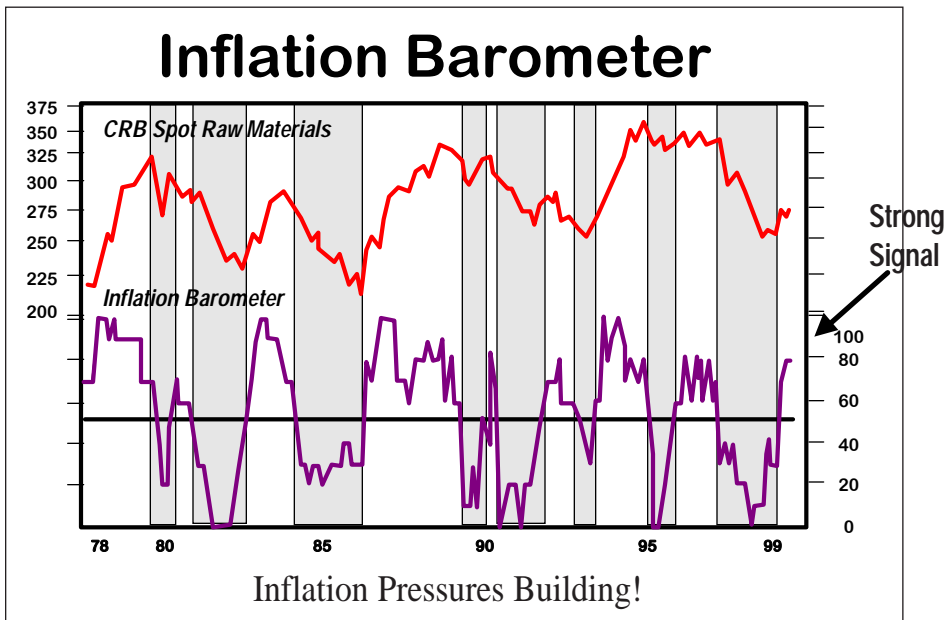
One key to year 2000 lies with the Federal Reserve. The Fed will continue to raise interest rates until they get their desired effect, which is to let some of the exuberance and speculation out of the stock market. *It never pays to fight the Fed.* Alan Greenspan warned that stock gains were fueling excess economic demand and this imbalance contained the seeds of rising inflation.

How did the stock market respond to this warning? In a slap to Mr. Greenspan, the markets immediately jumped up over 100 points. We believe investors would be well advised to heed Greenspan's words and actions. Rising interest rates will eventually drop the trap door under high-flying equities. The speculators have been warned!

**Greenspan Warns
Stock-Market Gain
Is Pressuring Economy**
Wall Street Journal, January 15, 2000

We have another reason to expect that the Fed may raise interest rates further and higher than is generally expected by investors. The reason is the recent "buy signal" given by the Pring Turner Capital *Inflation Barometer*. What the barometer is picking up is that sufficient forces and pressures have taken over that will result in rising inflation for the duration of this business cycle. We note that tight labor markets, jumping raw materials prices, and recovering global economies, are all combining to push the level of inflation higher. This will give the Fed additional concern and reason to raise interest rates.

One interesting aspect of inflation's return is that it allows pricing power, which is the ability to raise prices. This will result in higher profits, especially for natural resource and industrial type companies. Many of these companies have been neglected by investors the past few years and represent outstanding value.



We look forward to the year 2000. We are looking for a return to value this year as money shifts from the over-hyped, overvalued growth and technology stocks to the underpriced value stocks. The good news is that by braking the speculation in the technology and internet mania, money will actually go in search of real value. This year should see a return to sensible investing behaviors when stocks with good earnings go up. A steady course of proven time-tested value oriented investment principles will serve well even when the Fed removes the punch bowl from speculators. Yes, year 2000 will be the reality reconnect, *the year value investing counts*.