

July 2002

“Be fearful when others are greedy;
be greedy when others are fearful.”

— Warren Buffett

THE PENDULUM SWINGS

Three years ago investors, drunk with greed, fearlessly piled into technology and dotcom stocks. A new generation of inexperienced investors, spurred on by endless overly optimistic news stories, invested in the “New Economy” primarily because those stocks were going up. Today, now that the S&P 500 has dropped 45% in value and the technology darlings have dropped a staggering 75%, these “long-term investors” are bailing out of the market, primarily because those stocks are going down. Yes, stock quotations have been awful, but just as it was a mistake in 2000 to project gains indefinitely, it is also a mistake to project losses indefinitely. *The pendulum swung too far toward greed three years ago, and today it has swung too far toward fear. The pendulum swings both ways.*

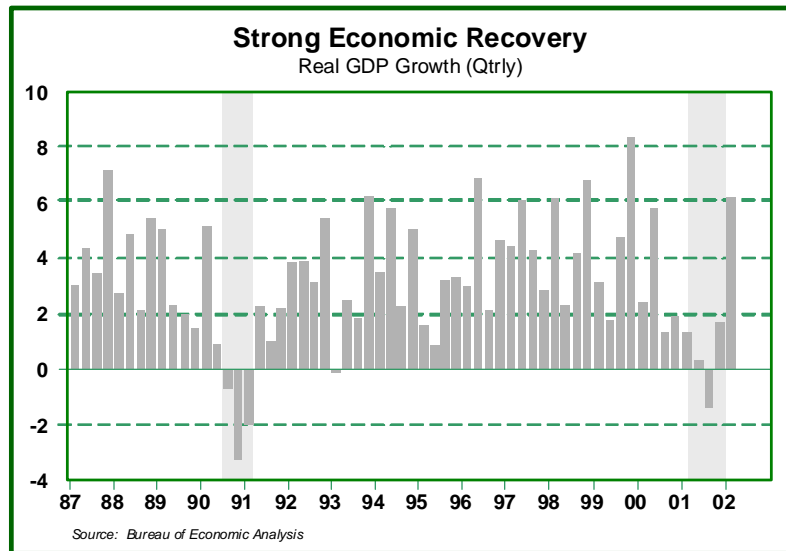
In the table below, I have summarized some key comparisons which demonstrate the radical swing in market conditions today versus 27 months ago.

	April 2000 (Market Top)	July 2002 (Market Bottom)
<u>News</u>	Positive hype, optimistic analysts and TV commentators. Bullish news centered on technology.	Negative hype, financial scandals: Enron, WorldCom, Arthur Anderson. Bearish news. “Dotcom to dotbomb.”
<u>Investor Sentiment</u>	High consumer confidence, greed, unrealistic expectations, fearless mentality. “Buy for the long-term” the new mantra.	Low consumer confidence, reality sets in, near panic, focused on daily news. Where’s the long-term investor?
<u>Market Valuations</u>	Extremely overvalued	Extremely undervalued
<u>Federal Reserve Actions</u>	Raising interest rates, worried about overheating economy, technology bubble, “irrational exuberance”.	Lowering interest rates, worried about slow growth, wants to stimulate economy, restore confidence to markets.
<u>Net Effect on Investors</u>	Overly aggressive, speculative, concentrated investments in “New Economy” stocks. Bulging investment flows into mutual funds. <i>Mistake to buy in April 2000.</i>	Conservative. Large net redemptions from mutual funds. <i>Mistake to sell in July 2002.</i>

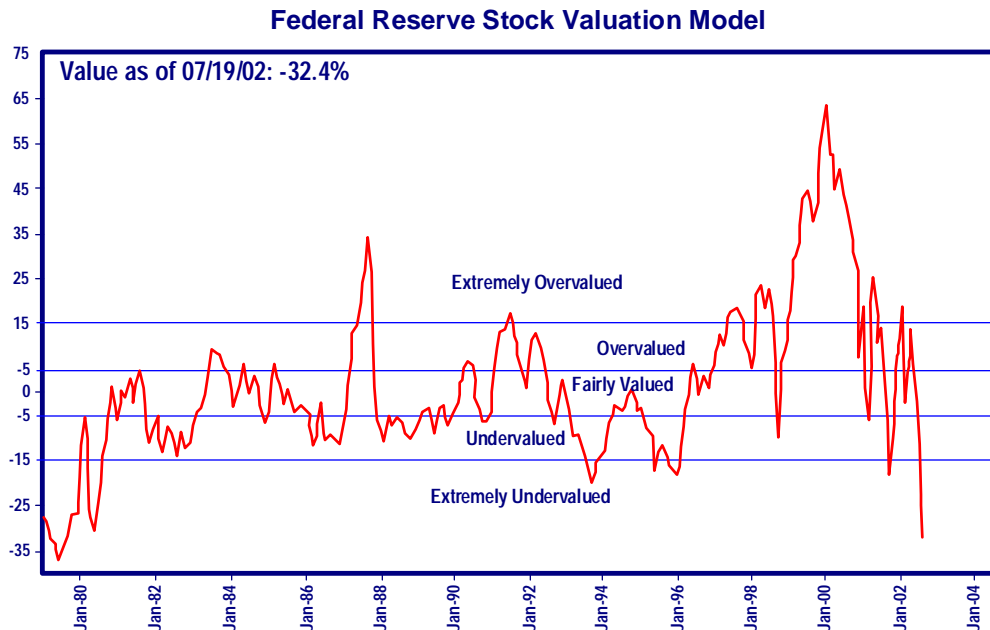
MARKET OUTLOOK

Beneath the negative news stories there are reasons to be optimistic. The economy is growing strongly, market valuations are cheap, and strong market rebounds always follow intense levels of fear.

After declining during the last half of 2001, the economy grew at an explosive 6.1% in the 1st quarter of 2002. The Federal Reserve is forecasting above average growth of 3½% for the rest of 2002 and 2003.



The stock valuation model below is one Fed Chairman Alan Greenspan's favorites. It compares S&P 500 earnings to Treasury note yields. *It currently indicates that the stock market is extremely undervalued by 32.4%, the most undervalued reading since 1980.*



Recently the S&P 500 Index closed down, for the tenth week out of twelve. This is a significant event and since 1950 has occurred only four other times. *Each period of persistent weakness over twelve weeks was associated with a significant market low and was followed by double digit gains, averaging 31%, over the following 52 weeks.* The table below highlights the results.

DATE OF OCCURRENCE	S&P 500 % GAIN 1 YEAR LATER
April 1953	+ 14.8%
June 1962	+ 33.3%
July 1970	+ 36.8%
March 1982	+ 39.2%
July 2002	? ?
Average Return	+ 31.0%

I believe today's avalanche of negative news stories, corporate scandals, and accounting irregularities, will soon lead to reform and higher stock prices as today's underlying positives become further recognized. Times like these are certainly trying on client nerves and stomach. I know! I also know that when this market turns up, entering a sustainable rise, or bull market, there will be some violent *up* days. *This frustrating, highly emotional market will reverse directions and produce strong gains over the next twelve months.* As I mentioned in my last newsletter, 2002 is shaping up to be the transition year where we move from Bear Market to Bull Market. I am confident that we are a few weeks, if not days, away from the turning point that will lead to a favorable stock market over the next two years.