

October 1, 2002

SPECIAL STOCK MARKET UPDATE

In my mid-July market newsletter I suggested that the pendulum had swung from extreme greed in April 2000 to fear and near panic in July 2002. I still believe that we are putting the finishing touches on the current 2½ year bear market and are set to begin the next bull market for stocks that could take us into 2005. Clearly, the bottoming process has been an emotional roller coaster with large market declines in July, followed by a big rebound in August, only to give it all back in September. Ending phases of bear markets (beginning phases of new bull markets) usually display a tug-of-war between bulls and bears with increased month-to-month volatility similar to this. When will the bear market end and the new bull market begin? How low can it go? How could it possibly move up with so many worrisome issues facing investors?

To answer those kinds of questions, I have often found it helpful to look at past history as a guide for the future. To paraphrase Mark Twain, although history does not repeat itself exactly, it sure does rhyme. To add perspective to current market conditions, I have compiled information summarizing the past bear and bull market cycles since 1960. Since 1960, there have been 10 bear markets with each followed by new long-term bull markets. Please take some time to study the table of information on the accompanying page. There are a few key points about bear markets I would like to highlight:

- Investors are always faced with negative news and many times a ‘crisis atmosphere’ which push prices lower.
- The average bear market lasted 12 months and took the Dow Average down 28%.
- The current bear market is in its 33rd month with the Dow Average down 37% and the NASDAQ down an astounding 78%.

This is currently the longest bear market since 1960, which is in sharp contrast to recent history. The last four bear markets have averaged closer to 4 months. Investors have not only suffered from the large price declines, they also have suffered through an extended period of time without a sustained rebound. Like Chinese water torture, the drip, drip, drip has heightened the emotional pain for everyone leaving the feeling that this will never end. While nobody knows for sure when this bear market will end, it is very long in the tooth, and I believe at a major turning point.

On an encouraging note, let’s turn our focus to the bull markets since 1960 that *always* follow bear markets.

- Bull markets begin at a point of maximum pessimism and “climb a wall of worry”.

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- Potential nuclear war, Vietnam, inflation, oil shocks, recessions, scandals, and other events created fear and uncertainty for investors as bear markets give way to bull markets.
- Bull market advances have averaged **+91% and lasted 37 months**.

It is important to note that the market will advance *before* (by usually 6-10 months) the economic news gets better. For instance, the 1982 bull market had advanced nearly 60% during the 10 month period *before* the government reported that the recession was over. In the 1987 “market crash”, the Dow dropped 20% in one day (October 19), which also marked the bear market low and starting point for the next bull market. Especially interesting in light of the current tensions with Iraq, the 1990 bear market ended in October, three months *before* the Gulf war started. Lastly, and amazingly, the stock market climbed steadily from 1939 to 1946 and did not experience a bear market during World War II.

I continue to believe that we are at or near the bear market lows for this cycle and on the threshold of a dynamic bull market that will last for two years or more. How can that possibly happen in light of recent events like corporate scandals, Iraqi tensions, recession, etc.? There are a number of good reasons to be positive about the economy and the stock market looking ahead.

- The Federal Reserve has lowered interest rates and is reflation the economy by growing the supply of money. (Yes, they can print money.)
- There is currently \$6 trillion in checking, savings, cash, and money market funds, the most ever. This compares to the total stock market value of around \$8 trillion. (There is ample buying power on the sidelines ready to lift prices higher.)
- Insiders have been aggressively buying stock for the first time since just after 9/11. (They see an opportunity in buying their own stocks at a discount.)
- Market valuations are attractive from several different important yardsticks.
- Investor sentiment is overwhelmingly cautious, and while that may seem negative, professional investors see it as a positive. (Fear and uncertainty are always present at bear market lows.)
- Corporations have announced major stock buyback plans. Buy back plans help support stock prices.
- The four year “presidential cycle” is about to begin. Since 1950 there have been 13 elections for president. *In every case*, the last two years of a president’s term has produced double digit gains averaging +58%. (Wouldn’t you want voters feeling better as your re-election nears?)

In summary, the ingredients are in place for a sustained bull market to begin, if it hasn’t already. I firmly believe we will enjoy a strong year-end rally that will mark the starting point of the next inevitable bull market. History shows that just as day follows night, bull markets follow bear markets. We have all been waiting long enough; it is time to have some fun again. I am looking forward to the opportunities ahead.

As always, please feel free to contact me should you have any questions.

HISTORICAL LOOK AT BEAR/BULL STOCK MARKET CYCLES

<u>Bear Markets Since 1960</u>			<u>News Events of the Day</u>		<u>Bull Markets Since 1960</u>		
Began Year	Length (Months)	Dow Average Decline	<i>As Bear Markets Give Way to New Bull Markets</i>		Began Year	Length (Months)	Dow Average Gain
1961	6	-27%	Cuban Missile Crisis, Cold War Tensions High		1962	42	+86%
1965	8	-25%	Escalation of Vietnam War, Riots in Watts		1966	26	+32%
1968	18	-36%	Auto Strikes, Violent War Protests, Soviets Invade Czechoslovakia		1970	32	+66%
1973	23	-45%	Arab Oil Embargo, New York Near Bankruptcy, Watergate Scandal, Egypt & Syria Attack Israel		1974	19	+75%
1976	17	-27%	Rising Inflation, Economic Malaise, “Stagflation”		1978	38	+38%
1981	15	-24%	Worst Recession Since 1930s, Mexico Bailout, Interest Rates Rise to 20%		1982	60	+250%
1987	2	-36%	Greenspan Raises Rates Sharply, “Program Trading” leads to Stock Market Meltdown		1987	33	+72%
1990	2	-23%	Iraq Invades Kuwait, Savings & Loan Scandals		1990	45	+74%
1994	9	-12%	Greenspan Fears Inflation, T-Bill Rates Double in 10 months		1994	60	+158%
1998	4	-21%	Asian Economic Crisis, Russia Defaults on Debt, Long Term Capital Bailout by Fed Reserve		1998	15	+61%
2000	33	-37%	Tech Bubble Bursts, Recession, 9/11 Attack, Corporate Accounting Scandals, Iraqi Confrontation		2002	?	?
Average (10 Bear Markets)	12	-28%			Average (10 Bull Markets)	37	91.2%