

Market Commentary – Wednesday, July 10, 2002

With market indices trending lower and volatility hitting extreme levels, many investors are asking the question, “Where is the bottom?” Market bottoms generally occur when both the news and the economy could not look worse and investors have completely thrown in the towel. So far, all of the components to a market bottom are in place, except for the general economic recovery that is currently taking place. Many investors have lost confidence in financial institutions and for good reason. Others have exited the equity markets in fear of external factors. Even more have been forced out due to their own self-demise. All of these aspects would suggest that market indices are approaching a bottom and many investment strategists now remain mildly bullish.

Giving reason for caution in today’s environment, however, is the current disconnect between equity prices and the U.S. economic recovery. Based upon Gross Domestic Product, the U.S. economy essentially “troughed” during the first quarter of 2002, posting growth of 5.6% during the this period (Source: Bureau of Economic Analysis). Historically, equity markets have not only recovered at the end of a recession but have appreciated significantly in anticipation of future economic and earnings growth. During this economic recovery, however, equity prices continue to lag, raising doubts as to its sustainability. Listed below are the 19 past economic recessions and the performance of the Dow Jones Industrial Average in the post “trough” or “recovery” period.

Dow Jones Industrial Average Five Months After Each Recession

Date	Performance
January 2002	- 9.2%
March 1991	4.0%
November 1982	13.4%
July 1980	8.4%
March 1975	10.6%
November 1970	21.8%
February 1961	7.6%
April 1958	14.3%
May 1954	10.6%
October 1949	9.3%
October 1945	7.5%
June 1938	40.9%
November 1927	16.8%
July 1924	16.7%
June 1921	15.2%
March 1919	20.1%
December 1914	18.0%
January 1912	12.1%
Average	13.9%

(Source: ISI Group/WSJ 7/02)

Certainly history does not always repeat itself, yet if it serves as a guide, one might conclude that there is ample room for improvement. Clearly there are reasons why today may be different, yet there are an equal number of reasons why today is the same. Interest rates continue to be low, inflation still appears to be a non-issue, and the U.S economy is recovering. All of these points would suggest that the current economic recovery is no different than previous ones and that equity prices will eventually follow.

So far it does not appear as if the market has bottomed. Bottoms generally take place, not when investors are looking for them, but rather when no one is interested. Should history serve as a guide, market recoveries occurring on the heels of economic recoveries are generally positive. Although the above evidence indicates that a bottom appears to be approaching, attempting to capture it precisely is useless. In today's volatile environment, more important than picking a bottom is sticking to a discipline or strategy.

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