



By Andre Weisbrod

## Happy Days Are Here Again? The Bull is Running!

It certainly is a pleasure to write about cross-the-board positive returns. For three years the stock markets languished. As I have shown in seminars and client meetings, there were five causes for the stock markets' worst bear market since the early 1930's.

First was simply that the market had to correct because gains had been too high in the 1990's. Markets, like the universe itself, tend to seek equilibrium, a reasonable balance among forces.

Second was a normal economic recession. When investors sense a slowdown or recession, they are less enthusiastic about buying high priced stocks, and many will sell some of their stocks. As recessions go, this one was a mild one and lasted only two quarters back in 2001. Had the causes stopped there, the markets would likely have rebounded as early as year-end of 2001, almost certainly in early 2002.

But terrorists hijacking commercial jets and crashing them into the World Trade Center towers and the Pentagon halted the natural economic course abruptly. This third cause resulted in a rapid and severe "event" drop. Event drops are usually short-lived, and this one was no exception. Within a few months the markets had recovered and were showing signs of resuming growth.

Then the fourth cause reared its ugly visage. The scandals at Enron, WorldCom and other large companies attacked something Al-Quaida couldn't: our trust in our financial system. The market dropped to new lows.

The fifth and final cause was the impending Iraq invasion. Amid that uncertainty, investors remained conservative and a lid was put on stocks.

At this point I began to write about buying opportunities and the almost certain recovery. Note that there was no recession in 2002 or during the first quarter of 2003. A "normal" market would already have recovered. So what are the causes of a bull market?

First, just as the market had risen too far ("overbought") by early 2000, so the market had retreated too far in 2002 and early 2003. The tendency to equilibrium became forefront. The market almost had to go up, simply because it was so far down and had been for so long. If you believe in the old adage, "Buy low and sell high," then this was clearly a time to buy. Sometimes the best course is the one that runs contrary to the crowd.

Second, the lid of the Iraq war was removed when the initial fighting went well. The

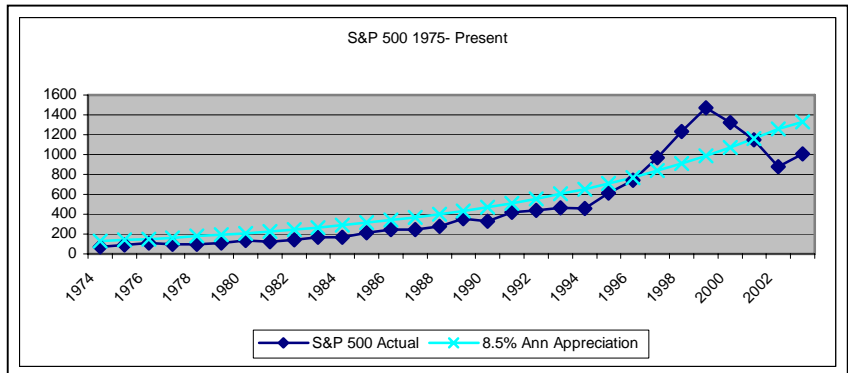
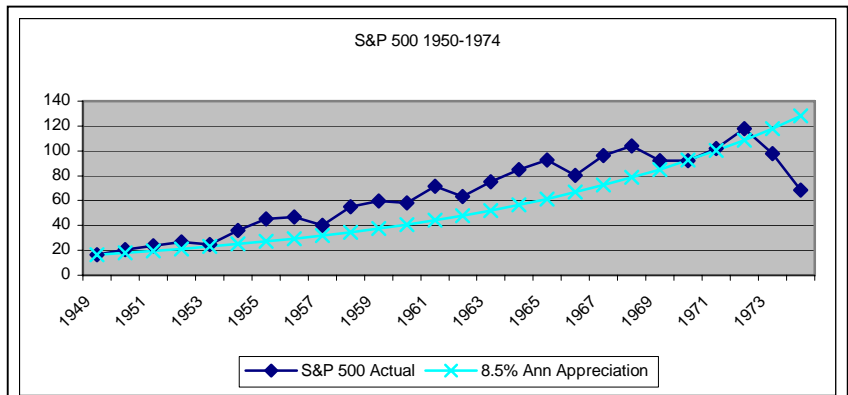
worst-case fears were not realized.

Third, the economy was growing. Once growth was confirmed, the stage was set for a return to more normal trading in stocks. The growth rate of the U.S. economy at the end of 2003 is expected to be 4% or more. A key part of the growth engine has recently kicked in. Business spending has increased.

On these three causes alone, large stocks (S&P 500) have risen almost 26% from their March 11 lows. The NASDAQ, the whipping boy of the doomsayers, is up over 42%!

If nothing else major happens on either the negative or the positive side, the market has an excellent chance to continue to achieve positive returns going forward. Expect normal fluctuation (volatility). Normal fluctuation would see 10%, 15% or 20% advances coupled with 5% and 10% "corrections" (downturns). Long term, the larger company stock markets have averaged between 10% and 11% average annual returns, including dividends. That is a reasonable long-term expectation for stocks.

I have done a long-term price study on the S&P500 (dividends excluded). If one assumes an 8.5% principal average growth rate (dividends not included) since 1949, then at the market peak in March 2000 the S&P500 was priced 52% above equilibrium! On March 11, 2003 the S&P 500 at 800.73 was



priced 37.3% under equilibrium. At the end of August, the S&P 500 would need to rise 43% over the next 12 months to reach this average growth line. While I don't think that fast a rise is likely, a return to equilibrium is very possible over the next five years, and such a return would require stocks to grow in excess of the 8.5% average. To reach equilibrium in five years would take more than a 15% per year price rise. Add in dividends and total returns for stocks would likely exceed 16% per year.

Right now there are more favorable causes than negatives. A short-term correction of 5%-10% would not be alarming. Assuming no major negative surprises, 2003 should

finish as an up year and 2004 would look promising. The Bear is back in hibernation and the Bull is awake and running. Risks are always there, but conditions are better now than at any time since early 1999.

The bond market was good for most of the first half of 2003. However, with interest rates at 45-year lows, bonds were poised for a correction as soon as the economic growth pattern was confirmed. Yields rose significantly in July and August and are now in a more balanced range. While the big gains in bonds are likely over, they still are appropriate instruments for income and risk balancing in most portfolios.

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