"A Strengthening Economy…And Stock Market"

Market Commentary – December 2002

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Iraq's Saddam Hussein continues to play a game of chess with the United States and the United Nations. While UN inspectors are currently in Iraq inspecting for weapons of mass destruction, it is unclear to what extent Iraq will continue to cooperate or what the inspectors will find. President Bush is waiting to use Congress's permission to attack Iraq. We are keeping an eye on the brewing situation. An initial market decline caused by war would likely be good opportunity to buy stocks.

According to recent data, the economy is recovering. Third-quarter GDP was 4%, which tells us the economy is growing. First-time jobless claims fell to a 21-month low. Unemployment peaked in April 2002 at 6.0% and rests at 5.7% as of October. Consumer confidence rebounded in November. Inflation has stayed in the low 3% range, despite the lowest interest rates since 1961. In summary, it seems that the economy is on the right track.

The federal government is pursuing active fiscal and monetary policies to help ensure the economic recovery. A Republican-led Congress is expected to deliver tax cuts to encourage investment and consumer spending. In November, the Federal Reserve surprised the financial markets by cutting interest rates a huge 50 basis points. With the Federal Reserve Board discount rate at 0.75%, the Fed cannot count on lowering interest rates much further to help the economy.

The stock market is confirming the strengthening economic data. November was an important month technically. The major indexes (Dow Jones Industrials Average, S&P 500, and Nasdaq Composite) built upon the end of October's gains and rallied to close November at the highest levels since August. As the indexes approach their August highs, which happen to coincide with their respective 200 day moving averages, the market may find some short-term resistance. Once the 200 day moving averages are taken out, however, a new round of buying should enter the market.

In terms of fundamentals, the market is fairly priced at current levels. We are cautious about buying the major indexes for this reason. Instead, we believe there are opportunities to find undervalued stocks with great earnings and bullish charts. We would rather buy specific individual companies than invest in the general market indexes.

In December, Wall Street will be anxiously awaiting data indicating the strength of retail sales this holiday season. The stock market will also likely see tax loss selling. Investors who have realized gains and unrealized losses in their portfolios will tend to sell their losing stocks, realize their losses, and use those losses to offset realized gains from other stocks. The result is a lower capital gain tax bill for the investor. Stocks that have been beaten down in the past couple months may have a rough December.

Banyan Asset Management's sector analysis shows that 83% of the market's 210 industries are in medium downtrends. The market has been in a holding pattern for a couple of weeks now. If the industries move higher, they will show up as weak downtrends or even as some sort of uptrend. Once we get confirmation that industries are creeping up into the weak downtrend or uptrend categories, we will put even more cash to work.

In the meantime, we rest on our current stock positions while the market figures out whether it will head even higher. Covered calls and dividends are generating income for our portfolios while the market meanders.