"War And Your Investment Portfolio"

Market Commentary – January 2003

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War with Iraq seems likely. The U.S. has deployed more troops to the Persian Gulf region in what appears to be preparation for battle. With the holidays almost over, the U.S. may want to attack during the cooler winter months. To add more fuel to the fire, North Korea recently decided to expel UN inspectors from its nuclear facilities. The timing of North Korea's decision is interesting given the high probability of a U.S. attack on Iraq. Banyan Asset Management still believes that an initial market decline caused by war would provide an opportunity to buy stocks. Our major assumption, of course, is that there is no major retaliatory attack on the continental U.S.

The economy is giving mixed signals again. Unemployment crept up from 5.7% in October to 6.0% in November, matching the 8-year high hit in April. Last week, however, first-time jobless claims dropped to their lowest level in almost 16 months. Retail sales for the critical holiday season are being called "the worst in 30 years". Inflation remains in check, with the Producer Price Index falling -0.4% and the Consumer Price Index rising 0.1% in November. Low inflation should correspond to a continued low interest rate environment. It remains to be seen how a war with Iraq (and possibly North Korea) would affect the U.S. economy.

Fundamentally, the market is still fairly priced at current levels. We maintain that buying undervalued stocks with bullish charts should be more favorable than buying the general market indexes.

The major stock market indexes showed resistance at their respective 200 day moving averages following the November rally. December's consolidation occurred on low volume, which is encouraging. The October market lows are critical. If those lows fail, then institutions will likely aggressively sell this market. The end of tax-loss selling should be favorable for stocks.

Our proprietary sector analysis indicates that money managers are being more selective about choosing individual sectors. From July through November, money managers appeared to have been repositioning portfolios based on asset allocation, rather than investing in specific sectors. We are now seeing a divergence, with some industries breaking away from the pack (both positively and negatively). Industries with positive money flow include: transportation, manufacturing, automotive, leisure, media, drugs, computer hardware, internet, and telecommunications. Industries with negative money flow include: retail and health services.

In December, we bought a few fundamentally and technically strong stocks on low volume dips. Our portfolios still have plenty of cash on hand to buy. Given the uncertainty in the market, we are in a balanced position so that we can benefit from a market rally, while being protected in case of a downturn. If the October lows fail, then we will look to raise more cash. In the meantime, we continue to enjoy income generated from covered calls and dividends. With the market's choppy technicals and fair fundamental valuation, Banyan Asset Management believes that covered calls will be a favorable strategy in 2003.