"Reversal Signals More Upside Ahead"
Market Commentary – November 2002

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The market seems to have made a bottom in October. Relatively high volume came into the major market indexes as the July lows were successfully tested. Market technicians call this pattern a "double bottom". In spite of this bullish development, we need to use caution before ringing the "all clear" bell.

Fundamentally, Banyan Asset Management calculates the Dow Jones Industrial Average to be worth 8700. In the mid-8000's, the Dow is fairly priced. On average, stocks are not a compelling cheap buy.

Consumer confidence fell off of a cliff in October, dropping to 79.4, the lowest level since 1993. Economists had expected a reading of 90. While business spending has lagged in 2002, consumer spending has held up relatively well. A weakening housing market and an uptick in unemployment could put more pressure on consumer confidence in the months to come.

The market is now putting more emphasis on the Federal Reserve's ability to use monetary policy to prevent the economy from slipping back into recession. The Fed meets the first week of November to decide its policy on interest rates. If the Fed does cut rates, money will become cheaper for companies to borrow. The idea is that cheap money will encourage companies to spend. The risk is that the market could view additional rate cuts as a sign that the Fed is worried about the economy, thus creating even more concern. If companies are concerned about the direction of the economy, they will limit spending and make an economic slowdown a self-fulfilling prophecy.

The brewing war with Iraq continues to develop. President Bush received permission from Congress to attack Iraq if he deems it necessary. Rattling sabers equates to uncertainty, and uncertainty concerns the financial markets.

Finally, elections are around the corner. Democrats and Republicans are struggling for control of Congress. It is unclear which party Wall Street favors. While Republicans tend to be pro-business (which is good for stocks), Wall Street has historically preferred grid lock on Capital Hill. When one party has too much control, Congress tends to spend too much money and run deficits. With a Republican in the White House, the market may prefer a Democratic-controlled Congress. The elections are a wild card.

We are pleasantly surprised that the market did not see more mutual fund redemptions as investors received their disappointing third quarter mutual fund statements. The market is entering a favorable time of year (November through April). Mutual fund tax loss selling is mostly over. Once we get through individual tax loss selling in December, portfolio managers should have the green light to put cash to work.

Banyan Asset Management's sector analysis is still weak, but there are signs that a reversal has taken place. Having been overweight cash since June, we are selectively putting some of that cash to work. The best opportunities to make money should be with individual stocks that are undervalued and have strong technical chart patterns. As the market continues to go sideways in a choppy fashion, we are building diversified positions on short-term market weakness. To capitalize on sideways market action and high volatility, we are looking to sell covered calls on some of our long stock positions. While our overall approach is still conservative, we are gradually dipping out toes back into the water. At all times we are maintaining our loss-sell discipline.