First Quarter 1999 Commentary

It seems that every evening we turn on the news to find that the Dow Jones Industrial Average or the S&P 500 Index broke a new record. For the first quarter the Dow broke the 10,000 barrier and increased nearly 7% with the S&P 500 increasing 5%.

So the question most people are asking is "if the market is so great, why aren't my investments doing the same?" The truth of the matter is that very few people are experiencing the performance figures of the Dow and the S&P 500. Why?

To answer this it is important to understand how the S&P 500 Index is calculated. It is natural to think that this is an index, which is comprised of equal amounts of the 500 largest companies in the U.S. But, it is not. The S&P 500 Index is market weighted meaning that larger stocks have more bearing on the performance of the overall index. For instance, Microsoft and General Electric (the two largest components of the index) together represent almost 9% of the total performance of the total S&P 500 Index. As a result, the top 50 stocks in the index represent a huge amount while the bottom 450 stocks represent a relatively small amount of the indices performance as a whole.

In 1997 there were 219 stocks in the S&P 500 that comprised the indices' positive return. By 1998 the number of stocks representing the return of the S&P 500 fell to only 77 companies. In the first quarter of 1999 there were only 18 stocks, which produced the positive return of the entire 500 stock index!

Now that we understand how indices can misrepresent reality, it is important to determine how the average stock performed in the first quarter. **The average stock in the S&P 500 Index rose less than 1% and is still some 20% off of its 52-week high. The 1,600 stocks in the ValueLine equal-weight index declined an average of 6% for the quarter and the S&P Small Cap 600 Index is down 9% for the quarter.**

The U.S. stock market's strength for the first quarter was concentrated in a few large cap companies and in tech stocks, especially those with an Internet connection. The large cap tech stocks in the S&P 500 gained 12% in the first quarter while the Goldman Sachs Internet Index increased 60% in the first quarter.

The first quarter also experienced an increase in interest rates, despite the fact that the Federal Reserve has not changed the discount rate. The yield curve on U.S. Treasury's increased on average ½% point and the Lehman Brothers long term U.S. Government Bond Index lost 4% for the quarter.

The bond market's weakness appears to be due to investor's uneasiness with the strength of our economy. However, it is important to note that, with the exception of a rise in oil prices, there is little sign of higher inflation in our near future. Our economy continues to benefit from improving productivity, low inflation, low interest rates and decent corporate profits.

As we continue to speed through 1999 it is important to recognize that just because a stock's name ends with "dot.com" does not guarantee it success. While tech and internet companies have done well over the short term, it is important to remember that most internet stocks do not even have positive earnings. Additionally, having *only* internet/tech stocks in a portfolio is gambling—not investing.

With the leadership in the broad market becoming increasingly narrow it is quite vital to reassess your investing goals and objectives. In doing so you will provide yourself a good idea as to what role different investments play in your personal portfolio.

If you have any questions please call. We appreciate the opportunity to work for you.

Sincerely yours,

Dave Sather
Certified Financial Planner