

Second Quarter 2000 Commentary

While the first three months of 2000 started off on a very positive note the second quarter did not start off too smoothly. On April 4th the NASDAQ market not only dropped 13% in one day—it also recovered almost fully that same day. It was an amazing roller coaster ride and certainly one of the most turbulent quarters in recent stock market history. In retrospect, it was a sign of things to come.

Much of the focus in 2000 has been upon Alan Greenspan and the actions of the Federal Reserve. Greenspan and company did not fail to deliver. In May they raised short term borrowing rates by another one half percentage point capping off a total of six interest rate hikes in the last year. Short term interest rates have now increased a total of 1.75% in the last thirteen months in an effort to avoid an inflationary economy. Whether these rate hikes have worked is yet to be determined. *It is important to note that while the Federal Reserve has acted several times, the economy does not typically show the effect of an interest rate move for about six to nine months.* As a result, we will probably know the full impact of our interest rate situation sometime around November or later. However, the economy is beginning to reflect weaker growth as measured by retail sales, housing activity and manufacturing orders and sales.

In assessing where interest rates go from here it is a fairly safe guess that if the Fed does anything it will be at their August meeting. Remember that this is an election year and it would be extremely unusual if the Fed raised interest rates in the fourth quarter. Furthermore, if we are at the end of a series of rate hikes then you can anticipate that interest sensitive companies (insurance, financials) will start to perform better.

After climbing at will in 1999, technology stocks realized that gravity does still exist. After reaching a new record in March the NASDAQ Index fell 37% by May 23rd. The heavily tech influenced index finished down 13% for the quarter. This was the NASDAQ's first losing quarter since 1998 and the worst quarterly performance since 1990.

Many large blue chip stocks didn't fair much better. The Dow Jones Industrial Average suffered in the quarter and is now down 9.1% for the year. Over the past 52 weeks the Dow stocks have experienced a negative 4.8% return. This is the first time the Dow has fallen in a June to June period since 1988 (a period that included the 1987 crash). While difficulties experienced by Proctor & Gamble, IBM and Microsoft held the blue chip index back there were several bright spots. Most notably, health care and pharmaceutical companies continued to post impressive earnings and were finally rewarded.

In examining today's stock market it is helpful to realize that the stock price of many new companies have benefited from being a "first mover"—the first to develop a new product or application. For example, in the case of Celera Genomics, it is quite impressive to be the first to have mapped out the human genetic sequence. Unfortunately, just because you are "first" you are not guaranteed commercial profitability. Celera Genomics is certainly not the only company in this situation. Internet and other upstart technology companies are facing tremendous hurdles as growth and earnings expectations are failing to measure up. Roughly half of the internet companies are not only down for the year, but are now below their initial public offering price. These stocks have fallen on average 66% from their high point. Some of the more notable names are Citrix Systems (-71%), Qualcomm (-68%), Amazon.com (-66%) and Celera Genomics (-62%). Obviously, these companies have got to deliver positive earnings. As this realization is internalized, investors are rapidly moving away from stocks whose only substance revolves around selling a "concept". *While concepts are a fundamental building block of economic development, sooner or later these concepts have got to produce earnings. Earnings are the only reason to participate in the stock market.*

If you have any questions or comments please don't hesitate to call or stop by.

Sincerely yours,

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