Investment Watch

3rd Quarter, 2002

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"One Dip or Two?"

After another brutal quarter in the stock market you'd expect me to lament our most recent losses in this seemingly never ending Bear Market, remind all of us that everything <u>eventually</u> comes to an end and that *we're in this for the long run*. But, there is plenty of time for us to console each other with a few bars from ***"Auld Lang Syne"*** when we recap the end of the year.

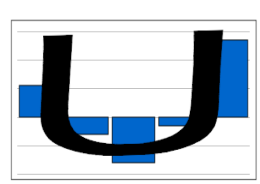
But for now, let's turn our attention to a more appetizing subject — **ice cream**. When it comes to ice cream two dips are <u>always</u> better than one. But, when it comes to the economy, two dips would be a disaster! It would mean a double dip recession! This is the current "flavor of the week" debate for the financial analysts and gurus alike … ***Will we have a double dip recession?***

A recession occurs when there is a contraction in economic activity marked by negative Gross Domestic Product (GDP) - that is negative growth. Why are we still talking about recession today? I thought Greenspan declared the recession over several months ago.

In analyzing the economy, the experts try to explain the recent past and extrapolate those results to predict the near-term future. But we should all know by now that **predicting the near-term future is impossible!** Why should we even go through this analysis and debate? Because it aids in the healing process. Because it's cathartic. Learning and trying to understand the interaction of the many factors that affect our futures seems to make the current financial disaster more bearable.

Now, let's use our 20/20 hindsight and turn the clock back to see how the prognosticators have changed their tune and led us down this primrose path to the current debate of ***One Dip or Two?***

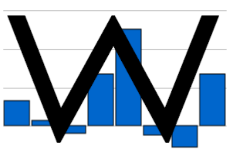
Twelve short months ago, the Bureau of Economic Analysis (BEA) reported an estimated 0.4% decline in the GDP — a recession! At that time and even today, there are many positive factors, which all the experts agree, should bring us out of recession quickly - a **"V" shaped** rebound. The pundits proclaimed after the longest economic expansion in history the shortest recession! The wonders of our "*resilient*" economy!



Then, just last July, the BEA revised the GDP for first and second quarters of 2001 (more than a year ago!) from positive to negative -0.6% and -1.6%, respectively. *Viola!* Their magic reshaped the **"V" shaped** rebound into a **"U"**! How quickly things change - even after the fact - due to revisions.

"One Dip or Two?"
(cont'd)

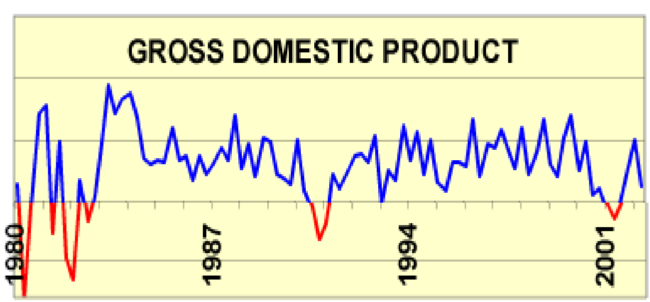
But then, a potential war with Iraq, creative accounting, corporate malfeasance, Enron, Tyco, WorldCom and even Martha Stewart ... where would it end? Did the ease and excesses of the '90's breed a new era of corporate villains? How widespread is this "Infectious Greed" about which Greenspan warned Congress? How much have these villains stolen from Americans' retirement security? Once again and now even more we feel helpless — we are Dazed and Confused!



The effect of the market on our savings has been devastating, but our economy seems not too much worse-for-the-wear. The question is will these events drag us down into a **double dip recession** or will our resilient economy weather this storm, bounce back and continue to grow? Unforeseen events could play a key roll when the future finally answers this question.

Greenspan, head cheerleader of our economy, keeps telling us the fundamentals are solid. Is he caught up in his own "irrational exuberance" this time? If you can concentrate on the economy and not let yourself be affected by the pain of this horrible bear market, you may find yourself on his team. Let's see!

How bad was or is this recession? Not bad at all - so far. Look at the chart below. If we don't experience a *"double dipper",* this reces-



sion will go down in the history books as one of the mildest ones in history. Still, we won't believe this. Then, let's look at some more facts -

- Dramatic increases in productivity have generated substantial household wealth, even with the market meltdown,
- Unemployment is only at 5.7% - a level that in the past we have called full employment,
- Interest rates are at a 40 year low,
- Mortgage rates have fallen below 6.0%,
- Inflation has been low for 20 years and is currently about 1.5%, and
- Producer Price Index actually fell 6% in 2001 and continues to be flat.

This is what Greenspan means by the fundamentals being sound. So why don't we believe it? Because we think (and we should be right) that the economy drives the stock market. Therefore, we believe that because the market is in a freefall, the economy must be horrible. Logically, the economy should have a cause and effect relationship with the market.

Contrary to logic, the economy and the stock market are **out of sync**. This disconnect started in the last two years of the '90's when the Tech Bubble drove prices beyond reality. At that time, emotions drove prices. Now, even though the economy is not weak, stocks continue their freefall. Emotions are again driving prices. Eventually when rational values are restored, the economy and profits will drive prices. But, until then, we must live in this world of discord.

Whether or not in the near-term the economy turns down again is anyone's guess. It may likely be determined by the aftermath of unknown future events. With respect to the economy, we'll let the future answer the question, ***"One Dip or Two"?***

But, the stock market has already given us its answer — **a <u>triple</u> scoop of rocky road!**

Keith Kowalczyk