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Good News / Bad News

Let's start with the bad news. ENRON is bad news. How did Sherlock Holmes word it to Dr. Watson? "The game's afoot." Well, this game's been afoot for a long time. For Enron, it's over; for the rest of us, it is not. Even though I did not own this stock, I, along with everyone else in the stock market, will suffer from the activities that brought down this company.

The earnings game has always been important to the stock market, but never as important as in the last seven years. Corporations have engaged in a fierce battle to maintain earnings growth. Growth is what keeps stock prices moving up and investment bankers and shareholders happy. But those quarterly earning reports required of U.S. companies also have a good news/bad news quality. On the one hand, you get timely reporting. On the other, you put companies under the microscope in unrealistically short time frames that have little to do with long-term growth. As one CEO put it, "It's tough when you have to weigh the baby every day."

When the game is about quarterly earnings instead of market share, long-term growth, and client satisfaction, bad things are bound to happen. For corporate America, the pressure to make the numbers (to grow the baby) is enormous. For many companies, the result is a 'whatever it takes' mentality. The modern version of this game involves lawyers and accountants in addition to the company's officers.

Accounting firms like Arthur Andersen are hired to verify the books of a company for us, the public, not for the company. They are the independent watchdogs for our system. It is bad news for American business and shareholders when these primary gatekeepers violate our confidence. There will be more companies with similar problems; there must and will be changes in the oversight procedures. The system has not collapsed but this injury to our confidence will slow the recovery of stock prices.

Now the good news. There are signs that the economy may have turned a corner. The Federal Reserve just finished its two-day meeting and decided to leave rates unchanged. It indicated that there are still signs of weak economic activity but the prospects of a recovery are improving. The forces that restrain the economy are weakening and "the outlook for an economic recovery has become more promising."

I do not expect the recovery to be quick or without bumps in the road, but I do think we are going to see more and more signs of progress. Stock prices may show some sizable swings in response to bad news of earnings restatements and good news about economic progress. Such a scenario may create some nice investment opportunities in the months ahead.