

The Tonge Telegraph

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Bulls vs. Bears

No, not a strange sports event . . . but a struggle for survival in our current version of the Roman Coliseum on Wall Street. As these rivals duke it out, I continue to see a lot of risk in the stock market, and I choose the cautious "wait and see" option over the aggressive "stay fully invested" approach.

The contest on The Street is not about the present but the future. We continue to see good reports on the economy and on corporate earnings. The jobs report in early April generated great enthusiasm, but the details revealed that real wage growth has turned negative for the first time in nine years. So, we finally have more jobs, but we have less income. The corporate earnings reports get rave reviews; earnings this quarter are indeed as much as 20 percent higher than last year for many companies. The sobering news comes in two parts. First, that increase rose from a deep trough during this quarter a year ago, when we were barely into the earliest stages of recovery and dealing with the consequences of invading Iraq. Second, as corporations report these good earnings, they are also guiding analysts to lower expectations for the rest of the year. In short, we shouldn't conclude that the earnings are going to continue at this pace.

I mentioned in an earlier newsletter that some sectors of the stock market had begun to turn down. Now I'm seeing this negative activity in most of them. Of the remaining sectors some, such as utilities and energy, are trading at sustainable levels while others look like they may be trading on the euphoria of yesterday's news. At some point, the factors contributing to 20 and 30 percent market increases over the past year--a low dollar, low inflation, low interest rates--will reverse and become wind in our face instead of at our back.

That's the analysis underlying my caution. Customarily as the Wall Street animals snarl and scratch, we might shift some money into the bond market and wait for the stocks to even out. Unfortunately, even though we're seeing some interesting yields on bonds, we're acutely aware that when the Federal Reserve decides to increase interest rates, bond prices will suffer. Some of this understanding has been priced into the market already and I have been able to buy some bonds recently. While I keep some money in cash, waiting for better rates to appear later in the year, I'm glad to find some four percent and even five percent bonds within the ten-year time frame. The happy thing about bonds is that we continue to get the interest rate we buy, regardless of what new rates do; and we will get our money back when the bond matures, regardless of what the price does between now and then.

As always, if you have any questions or comments please don't hesitate to call me. I look forward to talking with you.