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Smoother Sailing

The stock and bond markets behaved themselves last month. Equities continued upward initially, then cooled down a bit. The Dow settled around 9000. Bonds moved up again as the Fed reduced rates to 1 percent, a 50-year low. As usual, there are good and not-so-good scenarios suggested by these events.

I'm encouraged by the stock market activity. 'Normal' is the word that best describes it: moving up in anticipation of an economic recovery . . . which continues but will take some time still. The market foresees corporate earnings increasing substantially over the next twelve months. 'Substantially' would be the key word here, something in the range of 50 to 100 percent. Such a rise is not completely unreasonable to expect but--there's always a but--earnings increases of that size from this economy can only happen if things go very well.

Stocks generally are at a good level right now. The market has anticipated but not overshot moderate expectations of earnings growth. If the hoped-for further growth materializes, the market can move forward from here, projecting continued earnings growth over the next few years. But a market at this level means corporate earnings must fulfill the promise.

Bonds are a different story. Bonds have done very well the last couple of years, indeed over a decade's time, as interest rates have fallen. A calculation that includes the terrible stock market performance of the last 2 1/2 years shows that bonds have actually outperformed equities for that decade, very unusual and a boon for fixed income investors and retirees. But if the economic recovery that we all anticipate and hope for does materialize, bonds will suffer. An improving economy brings inflation pressures, and the Fed will increase interest rates. The bond market resembles the status of the stock market at the end of 1999. It has had a great run with almost every possible positive scenario in play for the bond investor. It is time for bond investors to step to the sidelines, just as, in 1999, it was a good time for stock market investors to do so.

I know there are no good yields to be found in short-term (i.e., less than two years) investments. And I know that just like stock investors in late 1999, nobody wants to sell their five-percent bonds. But it is time, and the prudent investor needs to make adjustments for the economic recovery we all anticipate.

Summer Fun: My favorite summer activity is to go sailing on Casco Bay in Maine. This scenic waterway just off Portland is one of the premier sailing areas in the world. I go as often as I can and love to share this experience with other folks. If you would like to go for a couple of hours or an entire day, I'd be delighted to have you with me. No experience necessary. Please check your schedule and give me a call.