

## The Tonge Telegraph

### November 2006

#### Changes

Heraclitus probably said it first (you could look it up!): The only constant thing is change. We adapt our lives every day to changes in the world around us. The markets also change, not just in the daily fluctuations but in macro sorts of ways. Several trends developing over the last five or six years seem to be moderating, and at the same time. First, the bond market, struggling through a series of seemingly endless discount rate increases, is now significantly stronger. Second, commodity prices, a burly bull market for several years, have now broken their uptrends. Third, the small and mid cap stocks that have lorded it over the large capitalization companies are finally making way for the less costly big companies to enjoy some progress. Finally, the strength of the market for the last six years has been in the Value stocks. Growth stocks suffered a significant meltdown, especially in the technology areas, after an extraordinary run in the late 90s. The result was one of the longest value cycles in market history. Now, that may be on the edge of change as well.

These changes are not detrimental to the market nor are they an indication that something is wrong with the markets. The analogy here might be the changing of gears in a car as the terrain changes. It's only common sense to shift from second to third, or conversely, as the road dictates. Markets change sometimes because the economy changes, sometimes because of world events, and sometimes it is because a certain style of investing (in this case value stock investing) has done very well over an extended period, thereby leaving other stocks behind . . . and now it's catch-up time.

This seesaw between growth and value stocks is one of the constants of investing. It's always interesting (and, I admit it, sometimes fun) to listen to the disagreements as a shift begins, and this time is no different. Last week, two of the best investment research organizations in the world came out with interest-rate forecasts that were diametrically opposed. One pre-eminent firm says that interest rates must go down while the other maintains that the Federal Reserve will have to increase rates next year. They have basically the same figures in front of them!

The economy is the foundation of the stock and bond markets. The economy is doing well but is not without its challenges. We will have to watch and see how this all plays out, but my expectation is that with the historically tough months of September and October behind us, and barring some wild political upheaval in Washington or the world, we should see several months of decent stock market gains.

Housekeeping item: Privacy Policy. I've enclosed the Tonge Investment Services notice of privacy policy with this month's statement. This does not require any action on your part, but should you have any questions, please do not hesitate to call me.