Chris Horan, Financial Advisor

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Out of the Woods?

Investors will have breathed a sigh of relief as their June 30th statements show that portfolios have recovered from the declines of the first three months of 2003, and will at least be positive for the year so far. Relief as the unbroken downward trend of the major markets that began 3 years ago in 2000 has finally ended and has actually turned slightly positive. Is it time to be bullishly optimistic again? Well, I have a degree in Economics, so my answer is yes, and no. Here's what I mean.

The first positive observation is simply that the global market declines of the last three years rank with the greatest declines in history. Between March 2000 and March 2003 the major US markets declined, peak to trough, by 50%. Other markets were worse: the tech-heavy NASDAQ declined by 75% and the German DAX index declined by 70%. The last time we had something like this was the 45% drop in the US (Dow-Jones) thirty years ago in 1973-74.

According to George Morgan, manager of the Templeton Growth Fund, major markets have declined by more than 10% for three years in a row only 4 times in the last 100 years. While there is, of course, the possibility of a 4th downward year, the point is that the more severe the storm, the less likely it is to reoccur anytime soon.

More good news is that the long term stock market trend (measured by the 200-day average of stock prices in the S&P 500 Index, the 500 largest companies in the USA) after being negative since September 2000, has finally turned upwards. Market analysts will tell you that while short-term trends (e.g., 30 day) change all the time, the longer term trends change much less frequently. This means that once a trend gets going, it tends to continue. So there are very good reasons for optimism.

The news media has widely reported that the market rise has been led by the recovery of the technology stocks. These reports are based on stocks such as EBay, up more than 70% this year according to the Financial Post. Rob Carrick even had a full-page article on how to play the tech stocks. Is it deja-vu all over again?

I agree with Tom Sassie, manager of the Optima US Value portfolio, who says that *never* has a sector that had led a boom and bust like technology, *ever* recovered to lead the market higher (think of the 'Nifty Fifty' in the 60s, gold or oil stocks in the 70s, or real estate in the 80s).

Not only that, but technology investors remain too optimistic, which is always a bad sign. For example, Yahoo and EBay both sport P/E ratios over 100; Amazon and JDS and many others still have not made a profit.

The tech stocks remain priced for a strong recovery and huge profit gains, and I think there is a low probability of that happening to those stocks as a group. (There will be exceptions: watch for the big-time IPOs like Google, to keep the dream alive by minting bazillionaires from time to time. Just like the lottery.)

No, the tech stock rally is more likely what investment pros call a 'dead-cat bounce': it might be going up, but not for long. If history is any guide (and it is) the tech and growth stocks may go nowhere for years.

However, back to the good news. The rocket-like performance of some tech stocks masks a positive trend in the value stocks. Value stocks, newsletter readers will recall, are companies whose stock price tends to be low in relation to the profits or assets of the company. Value stocks are frequently simply unpopular or unfashionable. The table below shows that value stocks as a group have actually kept up very well with the growth stocks (which include the technology stocks).

	6 Month Return to June 30th
US Value Stocks	10%
US Growth Stocks	11%
Cdn. Value Stocks	6%
Cdn. Growth Stocks	7%
* Source: S&P/Barra	

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Out of the Woods … Con't

There remain a great number of companies that are in excellent financial condition, have proven business models, are profitable, and their stock is reasonably priced. Companies like Royal Bank, which have generated a consistent 15% return on equity, pay a 3% dividend, are priced at a reasonable 14x earnings, and have very good management. Companies like McDonalds, the restaurant chain, are unpopular now because everybody seems to dislike fast food. Or dare I mention Exxon, the company that everybody loves to hate. These, and many similar companies, are the major holdings in the core of my client portfolios. Proven, profitable, and priced reasonably. (For more on value investing, please ask for my newsletter on the subject – I'd love to send you a copy.)

To summarize, I am optimistic that we may have turned a corner. I'm too smart to say we're out of the woods, but it isn't as dark. Chances are that investors in good quality companies with proven businesses will do quite well over the years from here. On the other hand, the tech and growth stock investors, with some brilliant exceptions, are likely to be disappointed.

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Moving Up

As you read this, we should be happily installed in our new offices. We're quite excited to be moving one short block west and 24 floors higher up at:

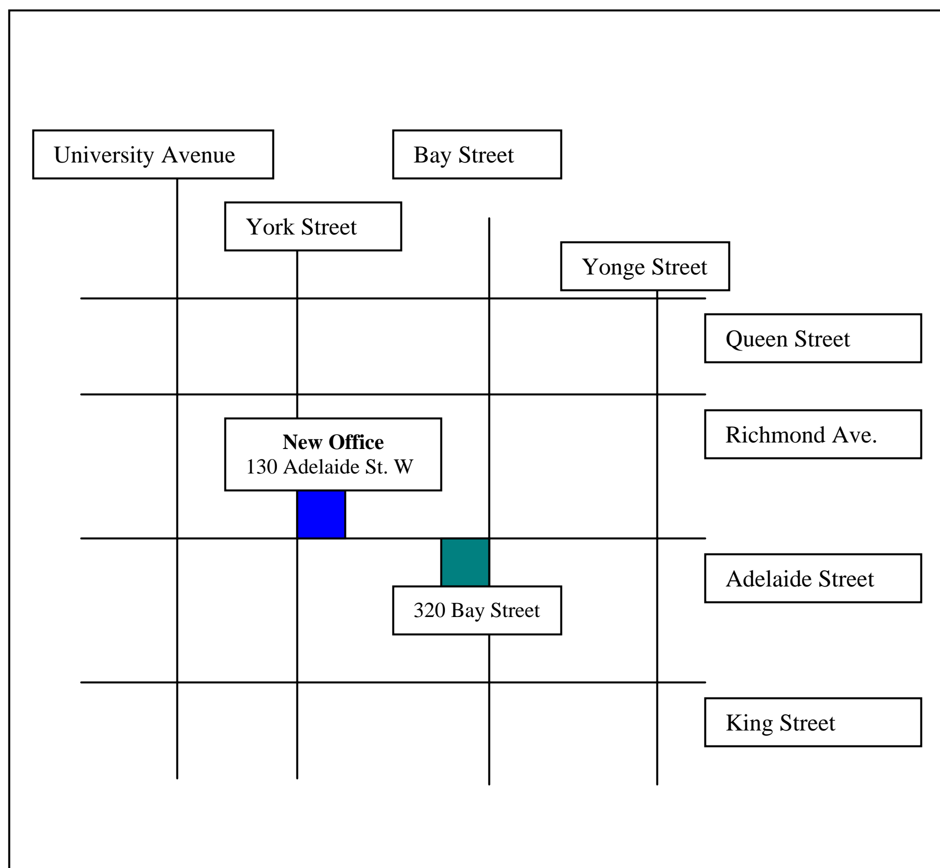
130 Adelaide Street West
Suite 3401
Toronto, Ontario
M5H 3P5

Our office is located at the North West corner of York and Adelaide Streets (see map below).

Our phone numbers are not changing, but *please keep the following in mind:*

We are taking the opportunity to move to a *direct dial format*. This simply means that you dial directly to my office, rather than going through reception. Please speak to my highly capable assistant, Barb McKenzie for all administrative matters, scheduling appointments or phone meetings, and so on. Of course, I am available to discuss any investment matter.

Direct Dial (Chris): (416) 216-6532
Direct Dial (Barb): (416) 646-3836
Fax: (416) 216-6512



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