Watch for market recovery

The sharp decline of stocks during the third quarter of 2001 makes it look like we are in for the worst two-year period since 1981-82.

ROB RIKOON

Real Money

Our country and most of the world was shocked and saddened by the events at the World Trade Center and the Pentagon early last month. So much has been talked about since then, and many people feel that the future remains more uncertain now than ever. The specter of subsequent disasters that might loom ahead remind all of us of the really important things in life: our families and helping others.

Whatever the immediate costs of repairing and rebuilding the changed lives and shattered world markets, I feel that people across our country as a whole, and the majority of people in the world, will pull together and that something positive will come out of the recent travails.

The direct damages from the terrorist attacks are estimated to be between $10 billion and $15 billion. Many billions more will be lost by businesses via the negative impact these events are having on consumer spending. The immediate aftermath of the bombings is that our already weak economy and previously nervous and negative investor sentiment have catapulted many investors into a kind of deep pessimism about our country's future. This is echoed in the psychological condition of most nations around the world.

That being said, I believe strongly that "the darkest hour is always before the dawn" and that these tragic events may have triggered the "capitulation" phase, which is usually a precondition to an end to a bear market such as the one we have been in for over a year. Bear markets often reverse themselves after climactic events such as the Kennedy assassination in 1963, the Gulf War in 1990 and the terrorist bombing of the World Trade Center in 1993.

Business
www.santafenewmexican.com
C
THE SANTA FE NEW MEXICAN
Tuesday
OCTOBER 9, 2001

Continued from Page C-1

Event	Date	1 week	30 days	90 days	1 year
Pearl Harbor	12/7/41	4.0%	3.8%	-2.9%	-9.6%
Cuban Missile Crisis	10/22/62	1.9%	12.1%	18.8%	31.4%
Kennedy assassination	11/22/63	5.5%	7.2%	12.0%	25.2%
1987 market crash	10/19/87	3.2%	10.6%	16.0%	23.0%
Iraq attacks Kuwait	8/2/90	2.2%	-9.7%	-14.0%	3.9%

The dramatic and now well-publicized retrenchment on the part of consumers is evident in people staying home and delaying travel and putting off big purchases. Business investment is now expected to continue to be delayed as consumer spending has all but dried up. Government revenues will go down dramatically as taxpayer incomes recede with the decline in economic activity.

"Uncertainty causes people to seek information and suspend their judgments and ... this affects buying behavior," says the director of consumer surveys at the University of Michigan. Many people are now fearful of going to public places, and this has had an immediate impact of deepening the recession. The Persian Gulf crisis in 1991 helped bring on the 1991 recession. Conversely, our nation's entrance into World War II built a national consensus to spend huge amounts of money in order to defeat the Axis powers, and this made the economy boom during the 1940s.

In conversations with clients, I point to the general pattern of the market: that following emotion-driven sell-offs in the wake of catastrophic events, the stock market then usually rallies strongly. The chart above summarizes these details.

Since the American economy has been weakening for a year now, the impact of a negative consumer and conservative business attitude might lead one to believe that the recession will be long and deep. However, the Federal Reserve Bank's stimulus should shorten the downturn.

In addition to the Fed's actions, central bankers around the world have also injected a tremendous amount of liquidity into the global markets. This is to reassure investors that national economies are basically sound and that fear should not gain the upper hand as it did in the 1930s. I feel that there will be a "W" shaped bottom to the current bear market.

The first downward slant, which culminated in the lows seen on Friday, Sept. 25, 2001, was marked by people who were driven by their emotions to liquidate their entire stock portfolios. This is because they fear the worst is going to happen, such as the start of World War III or continued successful terrorist attacks, either of which would basically freeze up the world's market environments.

In addition to emotionally driven selling, there are a good number of very intelligent people, who want to take reasonable precautions in order to protect their principal. Even well-diversified, conservative investors who had only a portion of their money in stocks for the long run are now nervous about the effects of the bear market on their present and future well-being.

The market should take a strong upward turn when this first phase of selling is over. The markets typically respond to the kind of radical cuts in interest rates we are now seeing worldwide with a strong updraft.

The most recent example was the coordinated rate cuts in the fourth quarter of 1998 in response to the Russian loan-default and currency crisis, after which the stock market rallied 21 percent. When our markets experience this kind of strong upsurge again, it will be hard to know if this is the end of the bear market or just a bear-market rally.

As many good-quality stocks have fallen 50 percent or more, such as EMC, Enron, Cisco, General Electric and American Express, the effect of having an overhang of potential inside sellers will probably be enough to put a damper on any initial stock-market rally. Such selling would lead to the above noted "W" pattern's second downward leg.

At the administration's request and with the approval of Congress, the $40 billion spending bill passed by Congress in mid-September will now likely be augmented by an additional $17 billion for the military and another potential $70 billion extension of credit to build alternate transportation systems.

The Immigration and Naturalization Service will be requesting huge budget increases, as will the Federal Bureau of Investigation in order to implement its proposed new authority to wire tap phones and screen e-mail.

Just how far federal spending will go is hard to tell, but juxtaposed against corporate retrenchment and layoffs, the future role of government looks much different than it did a few short months ago.

While it is unwise to make specific predictions about the stock and bond markets, when all is said and done, bear markets end when there are few sellers left in the game. Once the panic sellers, rational sellers, forced sellers and undiversified sellers are out of the market, there is little momentum left on the downside. No one can predict when the economy will recover, but we are sure that at some point, it will recover.

The market will already be in a long-term up trend well before the upturn in economic activity is evidenced in economic reports. When the fear is mostly gone, and sellers are no longer waiting to see at what point they can bail out, investors who are able to ride through this most-difficult period will be richly rewarded for their patience.

Our longterm view is that the ability of the world to deal with tragedy and crisis is predicated on people pulling together to respond constructively. These are the necessary ingredients to bring out the best in all of us.

Rob Rikoon is president and CEO of Rikoon-Carret Investment Advisors, New Mexico's largest independent money manager for individuals, families and nonprofit organizations. He can be reached at rrikoon@aol.com or at 989-3581.