THE SANTA FE NEW MEXICAN
D
Tuesday
NOVEMBER 13, 2001

Business

www.santafenewmexican.com

INSIDE

Mutuals D-3
Stocks D-4
Classifieds D-5
Comics D-6

optimism will see us through

RON RIKOON

Real Money

My daughter dropped some of her dinner on the floor the other night, and she said to me, "There's good news and bad news, Dad. The bad news is I dropped my food; the good news is we don't have to feed the dog tonight."

My daughter's slant on misfortune may also apply to our economy — that the bad news we are deluged with day after day can somehow be associated with some positive trends. My proposition is that even if we don't think that all the bad news is out about the economy and the stock market, we still have a good recovery to look forward to someday.

Optimism is part and parcel of the American way of life. It gives us energy to keep coming back to the marketplace with a resolve to pick up the pieces and go on even when things are difficult. Our inherent optimism is a very good thing because the worst news, as far as the markets are concerned, is the continued prospect for long-term uncertainty. Most people may not fully appreciate the importance of the current "crisis of confidence."

According to a recent comment by former Federal Reserve Board Chairman Paul Volker, the single most important factor negatively affecting the markets is the anxiety surrounding America's safety and what terrible thing might come next. The potential for devastating effects on the economy that even vague threats can produce has put most economic forecasting in doubt. After all, if California can contemplate shutting down its freeways because of "unsubstantiated data," we have a problem.

Individual investors have, for the most part, shrugged off these worries. People have piled back into the market this October, similarly as occurred after the previous lows in March. Because bull markets tend to begin when declines have lasted long enough to create ingrained skepticism and worry, this leads me to wonder if the final testing of the market lows has yet occurred.

It seems clear that the state of the economy is getting worse than most people appreciate. This summer, I wrote that we were already in a recession, though government

Please see RIKOON, Page D-2

RIKOON

Continued from Page D-1

statisticians and Wall Street wire houses failed to acknowledge this sobering fact. Since the attack on the World Trade Center, things have gone from bad to worse. What was purported to be a short and mild recession has been replaced by a powerful downtrend in economic activity. The fact that consumers have reduced their spending is clear and evident to anyone in high-end retailing.

So why has the market done so well these last few weeks? The key lies in investor hopes for the future. The market is anticipating the day when the upturn in consumer demand will materialize. Since Sept. 11, the Federal Reserve has taken the most aggressive monetary and fiscal action since the early 1980s in order to try to contain damage from our collective trauma. Most of us hope that this will underwrite a powerful and rapid upturn. In my opinion, that upturn is still some way off. A recent government report showed the sharpest monthly decline in retail sales since 1992. It is quite likely that if current trends continue, we will be looking at the largest drop in consumer activity since the spring of 1980 when there was a free-fall in consumer demand.

The situation today is quite different than 20 years ago. At that time, inflation fears drove investors to spend tomorrow's paycheck today in order to try to protect their dollar's purchasing power from eroding and to avoid high taxes.

The U.S. economy faces an arduous road to recovery. If declines in consumer spending continue, we will see increasing corporate layoffs because of poor corporate performance.

If, along with increasing unemployment, we add the higher cost of doing business due to security costs, we are likely to see a lowering of valuations for the stock market as a whole.

This would lend credence to the belief that the speculative bubble of the stock market in the late 1990s is now to be followed by a significant period of historical underperformance on the part of financial assets.

Because consumer expenditures count for approximately two-thirds of the nation's economic activity, it plays a decisive role in driving the rest of the economy.

Once a consumer stops spending, businesses start to reduce inventory. This sets in motion reductions in industrial production that further reduce levels of employment. That, in turn, stymies income generation on the part of consumers and the downward momentum gains force. As U.S. industrial activity declines, demand for imports goes down and this spells serious trouble for America's trading partners. If a sustained, consumer-led decline in the U.S. economy occurs in the upcoming few months, the aftershocks overseas will deepen the cyclical downturn here at home, creating a self-perpetuating global slowdown that only a significant shock will reverse.

So, what is the good news? For starters, the disaster in technology stocks should be pretty much over. Market leaders in areas of specific activity, such as Cisco and Nokia, have already started climbing out of the hole dug during the bear market of the last 18 months.

In broad terms, the deeper the recession we experience, the sharper the rebound later. As inventories are liquidated and people eventually satisfy their need for new equipment, the Fed's aggressive fiscal and monetary stimuli will take hold. The strength of the ensuing rebound of the market will take many by surprise.

When this might happen is an open question. Before the tragedies of September, I felt the rally would come early in the year 2002, but now it is looking like it will be later in 2002, if not well into 2003. Much of this depends on how people like you and me act and believe. Fortunately, we are a nation of individuals. We have the ability to make up our own minds about hunkering down to hoard food, water, guns and gold, or whether we will take an active role within our local economic communities. The decisions that generate our society's level of confidence are made one by one, in personal moments wherein we ourselves decide if our guiding philosophy will be fear or faith.

An important implication of a deep recession is that it will challenge the basic assumptions of many investors. Over the past several years, most owners of stocks expected and received consistently positive returns, so much so that alternate investments seemed ridiculous. Now, most people want to find investments that look like they won't lose ground. The main danger now is that when the economic cycle does turn around, interest rates will rise quickly and people who are presently buying bonds or funds sold today as "high income" will be compromised.

The business cycles of the last decade were led by productivity-enhancing devices and this led to above-normal economic growth during most of the 1990s.

Unfortunately, it is probable that now, under the specter of continued disruptions to normal business activity, more money will go to defense, security, information redundancy, shipping costs and insurance. Overall, our nation's productivity will go down. This is the major economic downside of the events of the past two months.

I wonder whether we will end up wasting tremendous resources on ineffective counter terrorism precautionary activities in order to instill the illusion that we are all safe and sound from enemy attacks.

If so, it will be as if we have collectively thrown in the towel and succumbed to terrorism's main objective, which is to disrupt. Because this is a psychological war fought about ideologies, through public relations and spectacular television-worthy displays of power, our government will end up spending a great deal of time, effort and money on giving Americans a feeling of security.

Most people are not overly worried about their personal safety but there is a general sense of unease about the economic future of the country. In order to retire, for example, we may well have to work harder to achieve less than we previously came to expect. This is not to say that stocks and bonds will not be productive in the upcoming years, but to a large degree, the stock markets operate on the basis of a collective sense of security.

Although our sense of comfort and "predictableness" has diminished, the good news is that we have opened the door to new ways of looking at our economy. A friend of mine on Wall Street, who was waxing philosophic to me recently, reflected on how things are going in the financial world.

He said, "I think God gives us just about as much as we can handle." If we can look at the markets' travails in such a light, I think we will be able to ride through the present difficult times with more equanimity and the eventual return of confidence may occur sooner.

As my daughter reminds me while we clean up the mess, "You know, Dad, someday I'm going to surprise you and take care of things. Then you won't have to worry so much." Progress comes to us in strange fits and starts, and when we are ready as a nation to move forward, we will. In the meantime, I remain an optimist though the signs all around may, or may not, easily justify such a rosy view.

Rob Rikoon is the CEO of Rikoon-Carret Investment Advisors, with offices at 510 Don Gaspar in Santa Fe and 1803 Louisiana N.E. in Albuquerque. He can be reached by telephone at (505) 989-3581, or via e-mail at: rrikoon@aol.com.