

## ***Are We or Aren't We? Recessions and the Stock Market. Feb. 13/01***

If you find it confusing watching the markets you should not feel bad. It is nearly impossible to make sense of the stock markets - in the short term. They are frequently irrational – in the short term. They are contradictory – in the short term.

Over the long term, markets make sense, and are the safest place for the majority of your assets to be invested.

Recently, the media and various analysts have been pre-occupied with two themes. Understandably, investors have been caught in a confusing and conflicting barrage of commentary. Allow me to offer a few observations to help clear the confusion.

You are the logical one here. If you are having trouble making sense of what you hear these days, it isn't your fault. It is that it doesn't make sense. Everyone seems at once concerned with the economy slipping into recession and with interest not continuing to decline. Today, the market went decidedly down. The reason? NOT that we are headed into a recession, but that we are not headed to recession. Alan Greenspan, the chairman of the U.S. central bank, testified that he did not see evidence of a recession and was not overly concerned about the prospects for the U.S. economy. Most of my clients are fearful of the economy slipping into a recession, *not* that it will avoid one. Most investors believe that what is good for the economy is good for their stock market investments. Apparently, the media and analysts believe the opposite. In the short term it is hard to make sense of the contradiction. One tip will help: the stock market is anticipatory. The market will typically move 12-18 months ahead of the economy. When the markets started falling in March of 2000 it was because they were predicting a recession this summer. Whether it comes or not is no longer of great concern. What is of more concern is whether interest rates will continue to decline. Declining interest rates mean that stock investments look relatively more attractive and might therefore attract more buyers, therefore increasing stock prices. When Greenspan says he is not concerned about a recession he is also saying that he is less likely to cut rates in order to re-ignite the economy. The market goes down as a result. Having already discounted this year's economic woes, the market is focused on next year's recovery. If rates fall precipitously, the economy is likely to rebound with greater strength next year (the year the market is currently anticipating and pricing).

But imagine this: what if Greenspan had said that the economy was a disaster? What if he had said that things are in freefall and we are headed for a terrible recession? Would the market have cheered the news and rocketed up? I doubt it. Is a bad economy good for your portfolio? No. However, in the short term the market is more concerned with reading tealeaves and sentiment than with the real issues that determine your success. When the market sentiment is negative, even good news is seen as bad news. When sentiment is positive, all news is good. It is this manic-depressive attitude that makes markets so volatile, so confusing, and so pointless – in the short term.

As I have written in my most recent commentaries, such periods of negative sentiment have always signaled great buying opportunities. We are in the midst of one now.

As a long-term investor, would you be happy with a strong and growing economy, coupled with falling interest rates? You should be, and that is what Greenspan is predicting. Here is one analyst's interpretation of Greenspan's comments. He is just one of dozens of crazed, confused and frightened market participants today. Your success as a long-term investor will be in part determined by the extent to which you do not join his ranks.

"Some people were disappointed that Greenspan did cite some signs of strength in the economy," said Ned Riley, chief investment strategist at State Street Global Advisors. "They saw it as an indication that maybe we aren't on a path to recession and that monetary policy might be applied more gradually than some had factored into the price of stocks."

Huh? I suppose then that a terrible recession would be good news?

Two other analysts attempting to explain all the doom and gloom on the stock market:

"Greenspan certainly didn't project an image of being tremendously concerned about a recession," said Jay Mueller, portfolio manager at Strong Capital Management Inc.

"He was basically saying the Fed would ease further but he didn't ring the alarm bells," said Robert Dederick, consultant for Northern Trust Co. in Chicago.

Remember, statements such as the above are harmful to your long-term financial health. No recession and falling rates is the ideal for investors. Should it come to pass, this will be a glorious buying opportunity.

If, on the other hand, the markets have accurately predicted a recession this year (and have therefore likely priced it into already depressed stock prices), then interest rates will fall further than they otherwise might, and the economy will eventually emerge from recession. As with past recessions, the market will begin rising as the evidence of a recession begins to appear. Markets are anticipatory. They will be rising during a recession because they will be focused on the recovery 12-18 months later. This scenario will make this time a good, but perhaps not glorious, buying opportunity.

The pessimistic utterances of today's short-term market watchers should be tolerated with pity but little else. They can be harmful if allowed to influence your financial planning decisions. It must be terrible for them. Imagine seeing only dark clouds and completely empty glasses everywhere you look, with never a silver lining or a drop of water to break the routine. Investors can rest assured that any short term confusion they experience in following the markets is a result of differing time zones. You live in the here and now. The stock market and its analysts live in next year.