

SUMMER 2003

THE INDEPENDENT ADVISOR

Quarterly Client Newsletter

How Do Investors Know- When Is The Right Time To Jump Back Into The Market?

Something strange has been happening since about mid-March of this year - - the stock market has been rising. As of July 17th, the Wilshire 5000, which is a broad measure of U.S. stocks, is up 14.42% since 1/1/2003. This time around even foreign stocks are participating, with the Morgan Stanley EAFE index up 7.6% in U.S. dollar terms. So the questions arise: are we at the start of another bull market? And if so, how should we be reacting as investors?

First of all, we should realize that much of the current upsurge is based, not on a strong economy, but on the expectation of an economic recovery. Unemployment recently rose to 6.4%, higher than most experts expected; and even though consumers continue to buy homes, clothing and other goods, there is little evidence of businesses beginning to make capital investments. Of course we must remember that economists always tell us that the stock market looks out six to nine months into the future, piecing together fragments of clues and data to arrive at a collective guess regarding the future economy.

The trouble is that the market's guesses can often be wrong. Both last year and the year before, investors bid up stocks, expecting a 2nd half recovery each year, only to be disappointed. The result was that stocks fell each year to new lows.

So how do investors know when the right time is to invest? The simple answer is: we don't. Anyone who tells you he (she) can predict the future is pulling your leg. Some of my favorite mutual fund managers, such as Marty Whitman of Third Avenue funds, say (and I'm paraphrasing): we don't make macroeconomic forecasts; we just invest in good companies that are priced cheaply.

Even when we do eventually begin to see signs of the long-awaited recovery, my concern is that stocks won't have much further to rise in the next year or two. Why? You may remember that my expectation of total returns from stocks and stock mutual funds over the next 10 years or so is about 7.5% to 8.0% annually, on average. As I mentioned above, stocks have already exceeded that for less than seven months of 2003.

So the investors who are plunging into stocks in recent weeks and months may, I'm afraid, be falling into that old 1990s ailment called "irrational exuberance." That is, their fear about the market setting yet more new lows is being replaced by greed. Many professional money managers, who tend to be overly optimistic, are pushing stock prices higher; their motivation is that they are afraid of missing another 15% or 20% surge.

Even small investors are surging into stocks though, according to some brokerage firm executives who look closely at trading behavior. During a week at the end of June, investors put a net \$3.3 billion into domestic stock mutual funds, capping 14 consecutive weeks when more money flowed into than out of funds.

(Continued on page 2)

AN INDEPENDENT FINANCIAL ADVISORS PUBLICATION

P 914-764-0367 F 914-764-0368 24 WATERBURY WAY, POUND RIDGE, NY 10576

My concern is that a lot of the money appears to be going into tech-related stocks, just as it did a few years ago; and this phenomenon seems to be very much greed-motivated. The tech-heavy NASDAQ is up already by 27.93% since January, even though sales and profit margins are still stagnant at most tech companies. Valuation is therefore another concern regarding tech stocks; they are quite expensive now when compared to company earnings. And, adjusting those earnings to account for one-time events, stock options and pension assumptions, Qualcomm's P/E ratio, for example, shoots from 28 to 258, while Cisco System's goes from 31 to 155. Looks to me like some investors might be throwing caution to the wind and jumping on the bandwagon again.

Individual investors should keep emotions out of their decision-making. The best way to do that is (and I know you've heard this from me before) to develop a comfortable asset allocation mix you can live with, say 70% stocks and 30% bonds and cash, for example, and stick with it, no matter what. If you find you cannot stick with it, chances are it's too aggressive and should be toned down, by dropping the percentage of stocks.

Further, if you have a lot of cash to be invested, the prudent thing to do is not to run headlong into the market with 100% of it all at once. Instead, consider getting up to your long-term asset mix gradually by putting your cash to work in the market in equal amounts over a number of months (called dollar-cost averaging). That way, you're "hedging your bets," so to speak, in order to avoid the possibility of investing everything at the top of the market. With all the mixed economic indicators on the horizon right now, surely the mass psychology called the stock market will present us with many ups and downs over the next few years. So my advice is to invest on a regular basis in good times and bad so that you won't feel that you've "missed the boat" if you haven't loaded up on stocks at any given time.

News Flash

There has been a lot of talk about a real estate bubble, but data published in the June 13, 2003 New York Times tells a different story. Granted, median house prices in the New York area have skyrocketed from \$183,800 in 1988 to \$329,400 in 2003; but due to ever-lowering mortgage rates, the median monthly mortgage payment over the same period, adjusted for inflation, has dropped from \$2,019 to \$1,519. So that means that houses have essentially become more affordable. That plus strong demand in the New York area means that it's doubtful a dangerous bubble is forming.

About the Advisor...

Christopher Kuehne is a fee-only, Certified Financial Planner (CFP), Registered Investment Advisor and NAPFA-Registered Financial Advisor.

He has worked in the financial services industry for 20 years in various capacities, including 12 years on Wall Street as a Vice President at Merrill Lynch and Bankers Trust Company. Mr. Kuehne has an M.S. in Economics from Carnegie-Mellon University, is a member of the Financial Planning Association (FPA) and the National Association of Personal Financial Advisors (NAPFA).

In his spare time he volunteers for the local land trust in Pound Ridge, currently serving as president.

Want to reference back issues of The Independent Advisor? Check out our website by going to

www.fee-onlyfinancialadvisor.com

or email us at

chriskuehne@fee-onlyadvisor.com