# Marathon Strategic News

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Commentary by Nicholas Terezis, CFA

## Economic Outlook

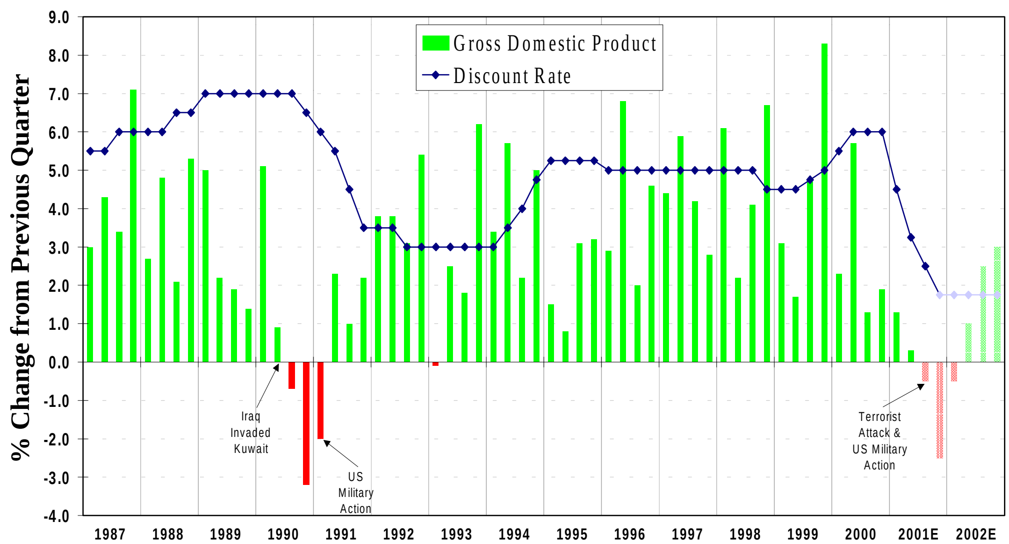
No one knows how the economic events and political environment will unfold over the next few months or quarters. However, market setbacks, recessions, and military actions are not new. The uncertainty we are feeling is similar to the way we felt in 1990 when Iraq invaded Kuwait and our military prepared for action.

When Iraq invaded Kuwait in July of 1990, economic uncertainty led to a recession (defined as two or more straight quarters of negative GDP) that lasted for three quarters. The initial uncertainty wore off after the first quarter of the recession, and the stock market began to anticipate an economic recovery. During the second two quarters of the recession, the NASDAQ advanced 40% while the S&P500 increased by 23%.

As different as it may seem now, there are striking similarities to recent history. In fact, one could argue that the economic situation now may not be as bad as it was in 1990. The country is unified, enabling the government to implement further fiscal stimulus; the Federal Reserve has already lowered the discount rate by 4% and will probably ease rates by another 0.5% in the next few months; oil prices are $24 per barrel and will likely remain in the $22-$24 range; inflation will likely be around 0.5% over the next twelve months; and the economy may have been on the verge of a recovery prior to the events of September 11th.

The main negative difference between now and the Gulf War is that Americans currently *appear* to feel more vulnerable now than in the past. This increase in vulnerability (decrease in confidence) is economically measured in the consumer confidence survey. Consumer confidence and spending, which accounts for two-thirds of the GDP, has remained strong up until the recent terrorist attacks. The events of this past month will almost certainly deliver a "consumer-demand shock" to the economy in the fourth quarter of this year.

**Quarterly Gross Domestic Product Growth Compared to the Discount Rate**




Source: Federal Reserve Bank of New York, Bureau of Economic Analysis, Marathon Strategic Advisors, LLC estimates. Note: GDP and discount rates for the second quarter of 2001 through the end of 2002 are estimates.

In the short term, consumers will likely postpone discretionary purchase decisions; thus the economy may seem a good deal weaker now than it actually is. It should not be a surprise to anyone if we see this reflected in poor fourth quarter corporate earnings and GDP results. Presumably, by year's end the initial shock of the terrorism will begin to dissipate. Further, <u>as long as there are no other acts of terrorism on US soil</u>, I expect that the economy will gradually move back toward a normal pace of events, consumer confidence will increase, and GDP will begin to grow again during the second quarter of next year. History has shown that the stock market increases in anticipation of economic recovery, and usually does not wait for investors to become comfortable with the investing environment.

I believe that investors would be well advised to do absolutely nothing in response to the recent tragedy. History has demonstrated that the impact of even the most momentous events on the securities markets is generally softened over time. Investors with well-thought-out financial plans that maintain a long-term perspective can generally ride out temporary market declines. Those who respond quickly and impulsively to events frequently undo perfectly sound plans from which they may never fully recover. The best time to invest is always the time at which you have the excess long-term-oriented funds to do so. It is the length of time you are invested in the market that has historically made the largest contribution to returns. Anytime you redeem assets while the market is declining, you risk missing the upward trends that often follow these periods.

There is no doubt that these are extraordinarily trying times. But we have been through trying times before, and the economy has always emerged stronger than ever. We have no reason to believe that this time will be any different.