Marathon Strategic News

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Economic Outlook

Preliminary evidence is indicating that the economy may have troughed and will soon begin to recover. Of course, we will not know with certainty until several months, or even quarters, after the fact. Nonetheless, we believe that the recent retail sales numbers, inventory reports, increase in consumer confidence, and upturn in the stock market are suggesting an economic recovery. Supporting of these first signs of recovery are a number of economic factors that tend to promote economic growth.

We continue to believe that the economy will rebound by the second quarter of this year. Setting the stage for this rebound are a number of favorable economic factors that tend to promote economic recovery. These factors include (1) low levels of inflation, supported by the increasing trends toward global trade; (2) short-term interest rates that have hit 40-year lows; (3) productivity that appears to be holding up even during this recession; (4) a healthy upwardly sloped yield curve, suggesting future economic growth; (5) a flexible monetary base, allowing the Federal Reserve to further reduce interest rates if necessary; (6) surprisingly low energy costs, thanks to our warmer relationship with Russia; and (7) a strong financial system.

There are two big investment lessons to be learned from the experiences of the past two years. The first is that future events are extremely hard to predict. The best way to deal with this uncertainty is by having a solid long-term investment strategy that assumes the occurrence of unexpected events. The second lesson is that diversification is paramount. No security should constitute greater than 3%-5% of a total portfolio. This is made especially clear when we witness seemingly strong companies (like Enron) evaporate almost overnight.

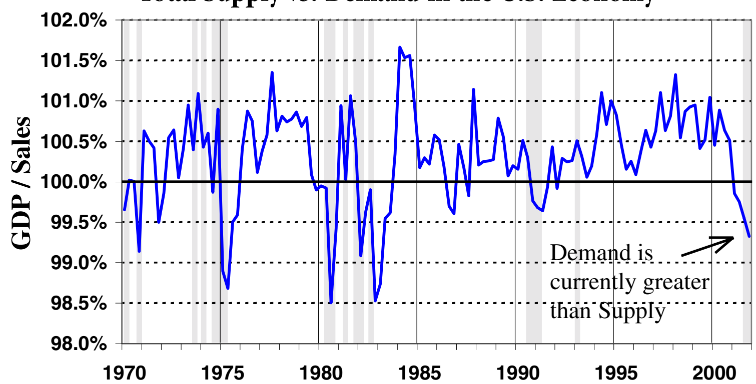
Further, we want to reinforce our belief that the exact timing of the economic recovery and the resulting stock market recovery should not be a major concern to long-term investors. To put it simply, it will eventually happen. As we have stated many times before, nobody can successfully "time the market." The best strategy in both bull and bear markets is to maintain a long-term, buy-and-hold investment strategy. We still firmly believe that the long-term outlook for the U.S. economy is very strong.

Understanding the Mechanics of a Recovery

Whenever the total demand in an economy consistently exceeds the supply of goods produced, it is only a matter of time before the economy recovers. This scenario has been present during all of the year 2001 (see Chart 1). The next logical question is "How long does demand need to be greater than supply before the economy recovers?" The answer to this question can be largely explained by looking at the levels of inventory. The lower the inventory levels the sooner that production (GDP) will be forced to increase.

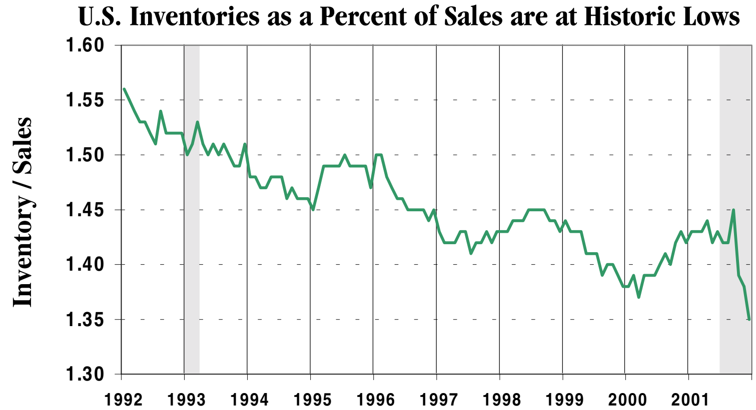
Inventory levels as a percent of sales are at historic lows (see Chart 2). Although technological improvements allow companies to hold lower inventories, we believe that the limit has been reached (given current technology). Any further significant decline in inventories may cause companies to experience operational disruptions. As companies begin to replenish or even just maintain their inventories, a greater level of GDP (supply) will be required.

Chart 1
Total Supply vs. Demand in the U.S. Economy



Numbers less than 100% suggest that Demand is greater than Supply, and that we are selling more than we are producing. "Supply" is U.S. Gross Domestic Product, and "Demand" is Real Final Sales of Domestic Product.

Chart 2
U.S. Inventories as a Percent of Sales are at Historic Lows



An Inventory to Sales Ratio of 1.35 means that, in aggregate, companies hold \$1.35 in inventory for every \$1.00 in Sales.

Source for both graphs: Federal Reserve Bank of St. Louis and Marathon Strategic Advisors, LLC estimates. Note: Q4 2001 are estimates.