Marathon Strategic News

201 East 86th Street, Suite 14C, New York, NY 10028 · (212) 996-9328 · www.mstrategic.com

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Commentary by Nicholas Terezis, CFA

Economic Outlook

Although it may not be evident when looking at the currently depressed values in the stock market, the economy staged a remarkably strong recovery in the first quarter of 2002. During this time, we estimate that GDP (Gross Domestic Product) grew at an annualized rate between 4% and 6% (see Chart 1)! We are confident that the economy will continue to recover this year barring any unforeseen escalation of war or domestic terrorism.

Why hasn't the stock market started to recover?

We believe that the stock market recovery has been delayed due to fears of war, higher oil prices, and corporate accounting issues. Usually, the stock market will rally in anticipation of an economic recovery. This time it appears that investors are waiting to see substantiated proof of an economic recovery in the form of increased corporate earnings. Further, it appears that investors are waiting to see what unfolds in the Middle East. Exogenous factors aside, we believe the economic fundamentals that support a stock market recovery are progressing.

Chart 1

Quarterly Gross Domestic Product Growth Compared to the Discount Rate

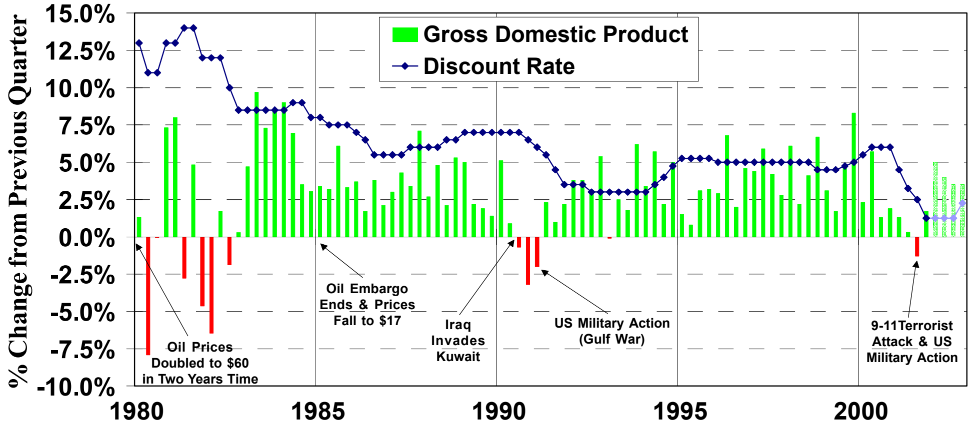
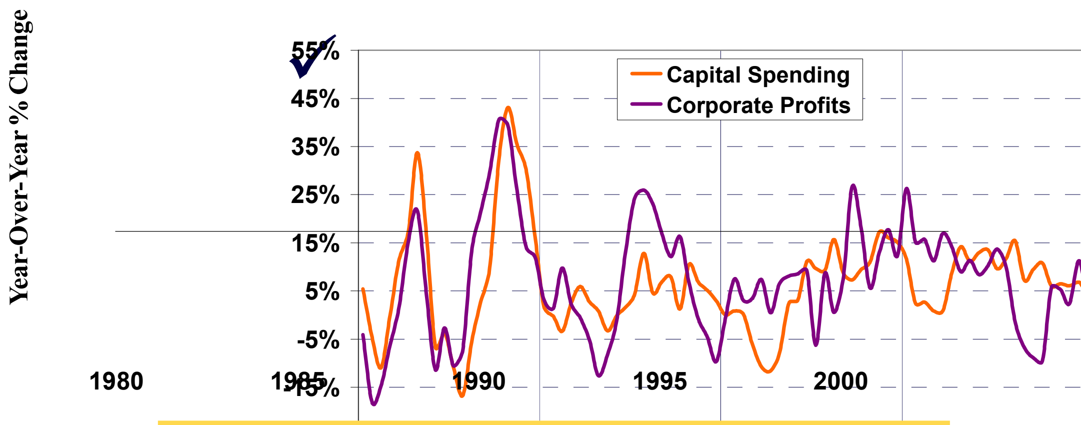


Chart 2

Capital Spending Changes Occur 4-8 Months After Corporate Profit Changes



Will Corporate Earnings Recover?

YES!! We believe that the continued increases in Industrial Production caused by the restocking of inventories and the improving economy will boost corporate earnings. The concept is simple: as production levels increase, the cost to produce each unit drops, driving the profit per unit of sales higher. This relationship between changes in industrial production levels and earnings has held through all types of markets over the decades, and we do not believe that it will be any different this time around.

When will Capital Spending Return?

Capital Spending tends to trail Corporate Profit recoveries by 4-8 months (see Chart 2). As a result, we believe Corporate Profits should rebound between April and August of 2002. Thus, corporate spending should rebound between October 2002 and February of 2003. Hard proof of a technology recovery (earnings increases) will take longer to materialize compared to industrial companies, because technology company earnings are largely dependent on the return of capital spending. However, it is important to remember that stock market movements occur in anticipation of future events.

Typical Economic Recovery Check List

- ☐ *Federal Reserve eases rates (started January 2001 and ended December 2001).*
- ☑ *Wait 9-12 months for lower rates to boost GDP.*
- ☐ *GDP Rebounds (Dec 2001).*
- ☐ *Wait 4-8 months for corporate earnings to rebound (expected between April and August of 2002).*
- ☐ *Corporate Profits Rebound.*
- ☐ *Wait 4-8 months for Capital Spending to rebound (expected between October 2002 and February of 2003).*

Source for both graphs: Federal Reserve Bank of St. Louis and Marathon Strategic Advisors, LLC estimates. Note: All 2002 numbers are estimates, "Capital Spending" is Gross Private Domestic Investment, oil prices are inflation adjusted to 1996 dollars.