Marathon Strategic News

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July 2003 **Commentary by Nicholas Terezis, CFA**

Economic Outlook

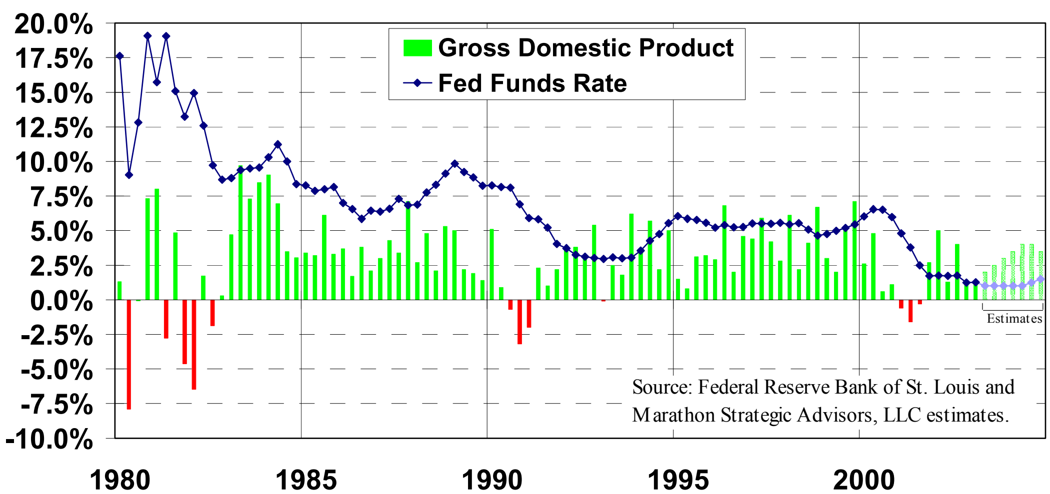
The economy and the stock market are steadily improving, and there does not appear to be any substantial barriers in the path toward stronger US economic growth. The methodical increases in monetary and fiscal stimuli have been enormous. As a result, we will likely experience the increasing favorable impact of these cumulative actions for the next two years.

Last month, the Federal Reserve prophylactically turned its monetary stimulative faucets up one more notch to full blast. It is now targeting a Federal Funds rate of 1.0%. This gives banks more incentive to make loans since they can now borrow from other member banks at a 45-year, record-low rate, of approximately 1.0%.

In May another round of tax relief was enacted totaling $350 billion (60% of which will impact the economy in the next 14 months). This tax relief lowers income taxes, curtails the marriage penalty, and lowers taxes on dividends and long-term capital gains. Our favorite portion of this law is the part that pertains to investments. Last year the maximum tax rates on dividends and long-term capital gains were 38.6% and 20%, respectively. Both tax rates have now been lowered to 15%, which increases the attractiveness of the underlying value of stocks!

For the past six quarters we have seen positive economic growth in the form of gross domestic product that has increased at an average rate of 2.6%. This foundation of a respectable, albeit sub-par, growth rate, together with such strong monetary and fiscal stimuli, leads us to believe that corporate earnings and the economy will continue to recover for the rest of 2003 and 2004.

Gross Domestic Product has Grown for the Past Six Quarters and the Federal Funds Rate is at a 45-Year Low



Questions & Answers

Recently, I have been asked the following questions.
Perhaps all investors would benefit from these responses.

Should I be worried about owning bonds in this environment?

Having a diversified portfolio is very important for all long-term investors. I do not recommend that investors move from bonds to stocks, and then back to bonds as the market prices gyrate. Investors should have an investment and asset allocation strategy that remains constant throughout all market cycles. Having said this, I believe that the portion of an investor's portfolio that is allocated toward bonds should have a lower duration in this environment. In other words, investors should focus on owning short-term bonds and avoid long-term bonds.

The total return of most bonds is composed of two pieces. The first component of return is the *fixed payment* that the bond makes to the investor. The second component of return is the *price*, which changes every day and is determined by the market. The fixed payment typically stays constant throughout the term of the bond. However, the price of the bond will go up when interest rates go down, and the price of the bond will go down when interest rates go up. Also, the amount of price change in a bond is magnified for long-term bonds compared to short-term bonds.

I believe that the risk of bond rates going up in the intermediate to long term is greater than the benefit of rates staying the same or going down. Therefore, I recommend investors should decrease their risk and lower the duration of their bond portfolio.

I was holding cash and waiting for the economy to look better before I got back into the stock market. Is it too soon or too late to buy stocks?
This is a typical question from a person who is trying to time the market. Superficially, market timing seems logical. An investor would naturally want to get out of stocks during bear markets in order to preserve capital. Likewise, an investor would want to buy stocks during a bull market in order to make money.

However, there is a substantial amount of empirical evidence suggesting that the odds are against your being able to successfully do this. First, you would need near-clairvoyance in order to anticipate the direction of the stock market during short intervals of time. Second, most big upswings in the stock market follow large downswings, and the period following a large downswing is typically the time when investor fear is at its greatest. Third, most gains have come in short, unexpected, intense bursts and are therefore easy to miss. For example, since 1930 the average of the 30 best monthly returns for the Dow Jones Industrial Average has been 14%. During this same period the average monthly return for the remaining 853 months has been 0.0%! In other words, if you missed the 30 best months (which was only 3.4% of all months) and were invested in the remaining 853 months, then your average 73-year investment return would have probably been around zero! The fourth and final reason why trying to time the market doesn't make sense is that every time you initiate a transaction you incur an expense.

The answer to the question is that the best time to invest is when you have the excess long-term-oriented funds to do so. Economic fundamentals are what determine the performance of the stock market over long investment horizons, and the long-term prospects of the US economy appear strong. Further, it is the length of uninterrupted time that you are invested in the market that has historically made the largest contribution to returns. So don't worry if you missed participating in this latest stock market rally. Prepare yourself for the future, correct your errors, and adopt a long-term, buy-and-hold investment strategy today.

What should I do if I want to be a long-term oriented investor?
Smart long-term investors are wary of the fact that people in general are ill-equipped to deal with the perceptions of risk and return over short periods of time. People often erroneously feel that economic facts alone are not a good enough basis for investment. They seem to prefer substituting hard facts with their feelings of fear or greed. They observe stocks going down and sell them. In fact, the more stocks go down, the more people feel certain that they should not be buying them. Conversely, real estate and bonds go up and people feel they should buy them, and keep buying them at any price. As we discussed earlier, smart long-term investors know that playing this game is tantamount to trying to time the market, and is thus a losing proposition.

In order to be a good long-term oriented investor one should do the following: develop an investment policy statement that dictates how much risk and return is appropriate given the unique circumstances and goals of an individual; determine the appropriate asset allocation based on the investment policy statement (i.e., the percent of the portfolio that should be in stocks, bonds, cash, and other investments); invest the portfolio wisely; and periodically rebalance it when the asset allocation deviates from the plan. Most importantly, long-term investors need to be disciplined. They must maintain their asset allocations in a buy-and-hold strategy during the ups and downs in the market.

Frequently, investors lack the emotional discipline and investment selection expertise required for the successful long-term management of their assets. In such instances I highly recommend that they seek professional investment management help from the most qualified person that they know. Serious investors are concerned about long-term total returns, not the hot stock that they bought and sold.

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