# Marathon Strategic News

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**Commentary by Nicholas E. Terezis, CFA**

## Economic Outlook

The economy has continued to strengthen even though the stock market has not yet shown positive results during the first half of 2004. Perhaps the reason for the stock market's lethargy is the perception that uncertainty in our economy has increased. At the beginning of the year, most people believed: the war in Iraq was essentially over; Bush would easily win the presidential election; the Federal Reserve would be on hold until after the election; long-term interest rates would move up slowly if at all; and the price of oil had peaked. Although this year may have ushered in greater feelings of uncertainty, none of these fears represents a true threat to long-term investors (with the possible exception of Iraq).

As the presidential election nears, I predict that politicians and the media will continue to sensationalize anxiety and fear. This will exaggerate topics such as terrorism, national security, budget deficits, political corruption, and corporate scandals. Harping on these issues may continue to project an exaggerated feeling of uncertainty in the stock market. With this in mind, investors should remain focused on economic fundamentals. The fact is that corporations are making more money now than they ever have in the past, and I believe that they will continue to have above-average earnings for at least the next year or two.

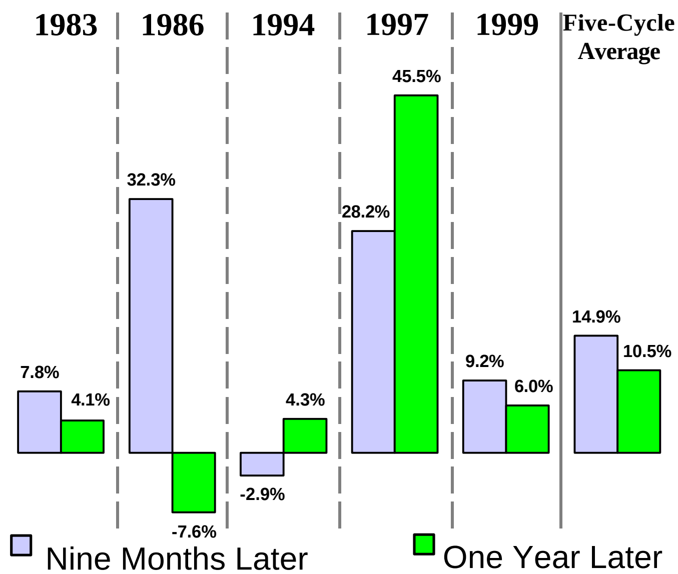
Although many people have strong personal feelings about the presidential election, the truth is that the results are not critically important to the economy. Historically, our economy has prospered under both Democratic and Republican presidents.

The news media has repeatedly stated that rising interest rates are bad for the stock market. This statement is true if we observe the immediate knee-jerk reaction to the first Federal Reserve increase in a cycle. However during the past five rate increase cycles (1983, 1986, 1994, 1997, and 1999), the S&P 500 index has actually <u>gained</u> an average of 14.9% during the nine-month period after a rate increase (and a total of 10.5% one full year after the first rate increase). Only in the 1994 cycle did the S&P 500 index lose money during the nine-month period that followed the Federal Reserve's first tightening.

Higher energy prices and high inflation expectations can be distressing. However contrary to the media's fixation on these issues, neither are at levels that are economically problematic. Barring any major oil disruptions, long-term oil supplies should <u>begin to notably outpace demand</u> over the next decade. Further, the current unsustainably high price of oil should revert back to the $25-$30 per barrel range in the next 6 to 24 months.

Despite the uncertainties of our time, the following list of positive factors will likely continue to support the growth of our economy: 1) low unemployment; 2) high productivity; 3) growing corporate revenues, profits, and capital spending; 4) the impact of previously-enacted tax cuts; 5) an upward sloping yield curve; 6) above average GDP growth; 7) an accommodative Federal Reserve; 8) low interest rates; 9) low inflation; 10) and low cost of carrying debt for individuals, corporations, and the government.

### Contrary to Popular Perceptions, Stocks Have Generally Gone Up After the Federal Reserve Has Increased Rates




Source: ISI Group

Do not be tempted by greed or induced by fear into trying to "time the market" – it is a losing proposition! It is the economic fundamentals that determine the performance of investments over long investment horizons. As I have stated many times before, no one can successfully "time the market." The best course of action in both bull and bear markets is to maintain a diversified, long-term, buy-and-hold investment strategy. Also, be certain to plan for an adequately long investment horizon. The average person celebrating his or her 65th birthday today has a greater than 5% chance of living past the age of one hundred.

If we continue to see the stock market improve over the next few years, do not change your investment strategy. Do not begin to concentrate your investments in any single stock, sector, or asset class such as real estate (see the October 2003 Newsletter for a full explanation). Stick to your long-term diversified investment strategy, and ignore any non-fundamental distraction. Wise investors always have diversified portfolios, because there is always uncertainty, and no one is clairvoyant.