"Our Clients' Past Successes are Not Necessarily Indicative of Future Successes."

Stamper Capital & Investments, Inc.

"Focusing on Upside Potential with Downside Protection Since 1995."

January 2001 Market Commentary

Last Year 2000 - As we forecast, last year turned out to be a rough ride for the equity markets and the lower quality bond markets. We made our forecast, in part, based on the very high equity valuation levels but more importantly on the fact that the high yield, junk bond (taxable) market had been crumbling for some time. The high yield market provides needed credit for a huge segment of the economy. We said, "This credit crunch and accompanying spread widening [of taxable junk bonds versus high quality bonds] may be the first signs of an economy that is dropping into recession. This change in the market will likely increase its volatility."

This Year - 2001

The Equity Markets - It turns out that valuation might matter after all. It first showed its face last year when the NASDAQ dropped about 50% from its high and around 37% for the year. Unfortunately, that index is probably still overvalued as are most others. MONEY magazine published an excellent article, "A Matter of Expectations," in its January 2001 issue. The article makes several important points that we agree with. First, is that the average annual return of the stock market is between 9% and 11%. Second, is that we have been substantially above that level recently and that the market will likely either go sideways for many years or drop to normalize recent returns to the historical average. Third, the article pointed out that the current multiple of dividends for the S&P 500 is at 86x compared to the 25x average multiple over long periods of time. Based on those statistics, we calculate that the S&P 500 is overvalued by about 71%, which translates into about a 7,590 point drop on the Dow Jones Industrial Average. While we do not know if that will happen, we think it sends a strong message to be very cautious when investing in the equity markets.

The Bond Markets - This category needs to be discussed in two sections; high quality bonds and low quality bonds.

High Quality Bonds - After last year's high quality bond market rally (the U.S. Treasury long bond rallied from about a 6.60% down to around 5.40%) we think expecting long-term interest rates to drop further is pushing it. In addition, the reaction to the recent 50 basis point lowering of short-term rates by the Fed was for the long bond to trade down (and long interest rates to go up). Thus, our view, which is not widely held, is that if the economy continues to weaken, the Fed will likely continue to lower, and long rates will probably rise, not fall. Accordingly, as far as high quality bonds, we think a shorter duration is more appropriate than a longer duration.

Low Quality Bonds - Spreads between junk taxable bonds and high quality bonds are almost as wide as they were during the short recession of 1990-1991 and we are not actually in a recession yet. However, we, along with the Economics Department at UCLA, expect that we will be in a recession sometime this year. Therefore, we believe that low quality bonds will continue to have problems. Accordingly, we would avoid lower quality bonds whose prices have not dropped. However, while we believe there will be opportunities for very knowledgeable investors in this sector, it is best left to those with considerable experience.

Conclusions - We believe the markets will continue to be volatile in 2001. The equity market continues to be overvalued by most historical valuation measures. We see signs that the economy is slowing down and we expect it to slip into recession sometime this year. Accordingly, we view most stocks as very risky. The bond market has its own issues. For high quality bonds, we believe short-term interest rates may drop but that long-term interest rates may rise. For low quality bonds, we believe that spreads will continue to widen; we also believe that short-term rates should be higher than long-term rates for low quality bonds (due to upside potential and downside protection considerations). Accordingly, we think higher quality, shorter duration bonds are the most appropriate for most investors.
