

“Our Clients’ Past Successes are Not Necessarily Indicative of Future Successes.”

## **Stamper Capital & Investments, Inc.**

“Focusing on Upside Potential with Downside Protection Since 1995.”

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### **January 2000 Market Commentary**

**General Comment** - Markets often swing from one valuation extreme to another - from too high to too low, relative to various valuation measures. Because this is true, one can say that it is prudent to stay invested even when prices of investments are higher than normal valuation measures suggest are reasonable. Why?, because prices continue to rise for sometime thereafter. However, at some point past reasonable valuation levels there is a transition from being an investor to being a gambler. It appears that the stock market is at that level now. The stock market could continue to rise even further, but by not taking steps to a lower risk profile at this juncture, investors are speculating, not responsibly investing.

In addition, the credit crunch in the high yield corporate bond market (see below), may just be the first sign that the economy is dropping into recession. If this is true, we can expect increased volatility in all financial markets.

**The Equity Markets** - The equity markets have been overvalued by most measures for some time. At the 11,000 level on the Dow Jones Industrial Average, valuation levels relative to historical norms are now highly speculative. At these levels, one should have an especially good reason for owning each individual stock in his or her portfolio. This advice goes against the now-more-popular-than-ever indexing approach, whereby participants simply own the market in general. Owning the index makes sense when market valuation levels are below historical norms; however, owning the market in general at current lofty valuation levels is questionable.

**The Bond Markets** - U.S. Interest rates represent a wide yield spread to expected inflation, especially compared to historical levels. It is interesting that the spread is wide despite the fact that the U.S. Treasury has been buying in U.S. Treasury securities and has lessened the amount of planned issuance (due to budget surpluses). This fact would seem to indicate that bond prices are low and interest rates are high (at least relative to expected inflation). However, there are several reasons to remain in more defensive bonds rather than more aggressive longer term bonds. The market could be discounting (including certain expectations in current price levels) the fact that foreign buyers have been the majority purchasers of U.S. Treasury refinancing over the last several years. If that buying goes away (or the foreign owners begin to sell their holdings), U.S. interest rates could go up and the spread versus inflation could widen even more.

While the spread to expected inflation is wide, corporate credit quality spreads have begun to widen out over the past year after being the tightest they had been in about

twenty years. This spread is the difference in yield of one quality of bonds versus another quality of bonds at equal durations (a type of average maturity) on the yield curve. A typical comparison is that of the yield of a AAA-rated corporate to the yield of the U.S. Treasury yield curve. Another comparison would be the yield spread between B-rated corporate and BBB-rated corporate bonds, and the yield spread between BBB-rated corporates and the U.S. Treasury yield curve, etc. Yields of lower quality corporate issuers have gone up rather dramatically in response to a credit contraction, whereby lower quality companies are having difficulty refinancing their debt and are being forced into restructuring or bankruptcy. The result has been a dramatic increase in yields for these lower quality issuers. We are just beginning to see this phenomenon in the municipal bond market. Widening spreads will eventually present exceptional investment opportunities in lower quality debt securities; however, we must stress that in this market, in particular, taking advantage of those opportunities requires dedicated, institutional investment expertise. In addition, this credit crunch and accompanying spread widening maybe the first signs of an economy that is dropping into recession. This change in the market will likely increase its volatility.

**Conclusions** - The equity and lower quality bond markets are worrisome at current levels. The equity market is exceedingly high by most valuation levels and staying invested without some sort of risk control is speculative. The bond market looks more inviting especially considering that the yield spread to expected inflation is very wide; however, we believe it is better to stick with higher quality bonds until credit quality spreads finish widening out. Because the economy could be slipping into recession and volatility could increase, we recommend a lower risk approach to all financial markets at this time. In both markets you should have a very good reason for owning each security in your portfolio -- we believe just owning the market in general could be hazardous to your investment health.

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Stamper Capital & Investments, Inc. has been the sub-adviser to this Fund since October 1995 and B. Clark Stamper, our President, has been its Portfolio Manager since June 1990.

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