GSI Market View

1st Quarter 1999

We thought it might be interesting to revisit our first quarter 1997 newsletter where we began by talking about the decision of a friend at a 1996 Holiday party to exit the common stock market. *His rationale was that after two years of strong equity returns, he should capture his gains (tax rate 28%, then) and avoid potential loss of principal*. After all, his income was adequate from municipal bonds, and otherwise he was in good financial condition. He had recently retired and he wanted to reduce his risk. But, knowing this person, he had timed the market before. *He was more a trader than an investor, and he did not experience success investing in the common stock market*.

At this very time, there are probably people who think about taking the same action as our friend did in 1996. The common stock market is historically high, uncertainties exist around the world (there always are), it is hard to determine the direction of interest rates (it always is) and that year 2000 problem could do us in. You may think of other reasons. *So is it time to sell all our stocks? We don't think so. Is it time to be cautious? Yes, but not blindly so*. When approaching the question, ***what do we do now***, we should revisit our investment objectives.

First, we should reconsider our investment time horizons. *Unless we plan to make use of our funds in the next few years, disruption of our asset mix (stocks vs. bonds or stocks vs. cash) could be very penalizing longer term*. For example, last August/September we heard about (1) recommendations to sell stocks and buy bonds, and (2) sell stocks and let the money rest in money market funds. *Both turned out to be bad moves unless the decisions were reversed in October*. We doubt that many investors timed those decisions well. Value lost could have been substantial.

The second review should be risk tolerance. *If one's common stock ratio has become significantly higher* than one's initial objective due to stock appreciation, *it might be prudent to reduce equity exposure*. However, time horizon is important here too, because this decision may be more important for a retired person than for a young wealth builder. Taxes would also be a consideration for taxable accounts. *The other issue relates to one's ability to deal emotionally with a sharp decline in the equity market*. If last August/September caused you to panic, it might be wise to consider a reduction in equity exposure now, rather than when and if we have the same experience in 1999.

We think it is quite possible that a sharp decline in stock prices could occur in 1999. We also think that the positive trends that have carried the markets in recent years remain in place and will support strong markets in the next few years. We would like to expand on these two points.

Rather than going through a litany of events that could upset the markets in 1999, we would like to focus on one. It may not be the event that disrupts the markets, but it is one that concerns us most. That is the Year 2000 problem. Few really know how this issue will play out in 1999 and 2000. No doubt we will have estimates of the situation by both optimists and pessimists. *Psychology surrounding the issue could be worse than the issue itself*. Billions of dollars are being expended on the problem, but we don't know the degree of solution at this time, and we won't know until the switches are turned on January 1, 2000. *At any time in 1999, fear of the event and not the event itself could cause a market decline*.

<u>The positive longer term view is based on economic and demographic fundamentals that should continue into the next millenium</u>. *<u>The innovation revolution</u>* caused by the computer, the internet and telephony should race along. *<u>Corporate profits</u>* should continue their upward move and *<u>government spending</u>* should continue to make up a smaller part of Gross Domestic Product (GDP). *<u>Unemployment</u>* should remain low and *<u>productivity</u>* should remain strong. Inflation should remain low. In fact, economist Larry Kudlow stated recently on CNBC that it could be non-existent in 1999.

Robert Rubin, Treasury Secretary, has stated that he will stay in office even if President Clinton is forced out. Alan Greenspan has proven to be an outstanding Federal Reserve Chairman, and it is clear that *<u>he will change short term interest rates in order to keep the economy moving forward</u>* on a steady growth path and to steady the security markets. *<u>The baby boomers will continue to pour savings into the marketplace</u>* in order to build up their retirement funds.

<u>So, the longer-term outlook remains positive</u>. At this time, we feel investors should review their investment objectives and guidelines to confirm the positioning of their portfolios. Also, double check how courageous one will be if the market nosedives sometime this year.

<u>Client portfolios did well last year at GS Investments</u>. Depending on client objectives, <u>b*alanced portfolio returns ranged from 20% to 29% (including income) while equity portfolios returned between 29% and 39%.*</u>. Our composite (all accounts considered) equities were up roughly 32%. All returns reported are after fees and including income. *We have heard that 86% of equity managers failed to beat the S&P 500 which was up just over 28% for 1998*.

We were pleased to have our business grow in 1998 due to strong market results and new clients. *<u>Please consider recommending us as an investment manager when you learn of someone looking for investment management service</u>*. Have a great 1999!

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