GSI Market View

3rd Quarter 2000

What has happened! For the past few years and through the first half of this year, our economy was sailing along at top speed with only some moderate setbacks. The last great worry was Asia's downfall in 1997. We managed to effectively process that problem and surged ahead until this year when changes took over. Energy prices, the election, interest rates, the Euro and the Middle-East conflict converged, acting as a boomerang on our markets, bringing them down dramatically. *Now, we seem to be experiencing a reality check to see if this New Economy will prevail or fall apart.*

Viewing the stock market collapse in October 1987, we can now look back and argue that stocks were out of line with the bond market. Said another way, stock prices were simply too highly valued when contrasted with returns available from bonds. In spite of this, the economy was healthy and stocks continued to move upward. That is until October, when they fell sharply, declining 20% in one day. That was a shock to many. The psychology related to that decline was devastating. *Many investment managers sharply reduced their stock holdings, and did not recover from the sell-off. Much of this was due to the fact that many did not reinstate their positions in time to capture the upward move in January 1988.*

When comparing and contrasting the economy now to the economy in 1987, there are probably more differences than similarities. *What is similar however, is stock valuation and crowd psychology*. The stock market seems to be trying to adjust to slower economic growth. Shifting down to 2.7% GDP growth last quarter from 5.8% growth in the second quarter represents a sharp change. Some cyclical stocks (autos, railroads, etc.) and poorly capitalized (need money or have borrowed too much) companies have suffered.
Investors have pummeled the entire telecommunications industry, projecting a dramatic decline in the rate of capital spending. *We don't see dramatic deceleration, rather a mild slowdown; one that should support strong corporate profits (for those appropriately positioned) for some time to come*. Specifically, two of the telecom companies we own had strong third quarter reports but were torn in the marketplace. One was Nortel and the other JDS Uniphase. *There was clear overreaction and panic by some managers anticipating and following the reports of these two companies. Since then, their prices have declined, creating what we feel are reasonable values.*

In addition, one analyst lowered his estimate on Intel. The stock collapsed from about \$65 to \$35 before righting itself and moving up to its current price of \$46. Although a weak Euro and new product introduction problems caused third quarter earnings to be slightly below expectations, the price correction was unnerving (and unfair we feel) for many. *Clearly, negative psychology weighed heavy on the price moves of these good companies*.

One major uncertainty will go away on November 7. We will have a new President *and Vice President and they will have articulated their program for managing the U.S. The uncertainty left will be if and when political rhetoric will be carried out.*

Short-term interest rates are high and biting at the current time. However, inflation remains under control. The Federal Reserve has demonstrated in the past that if a slowdown is severe, it will lower interest rates. *Now, we hear more talk about lowering rates than increasing them.* So, the pendulum could swing the other way. Common sense tells us that no administration or financial authority wants to see a budget deficit and increasing unemployment. *Engineering a soft landing for the economy has to be a high priority for fiscal and monetary authorities*.

The Euro has dropped sharply in the recent past. When first created, one had to believe that societies with different cultures and spending habits would have a hard time putting this multi-nation currency together. One can now argue that the stakeholders will find it near impossible to turn back. So, it would seem that the countries involved would eventually make it work. *It is reasonable to think that most of the adjustment is over and at some point soon the Euro will stabilize and begin to rise relative to the dollar*.

The toughest question and uncertainty in our minds is the energy problem. It seems to us that this is a political issue as well as a supply/demand issue. Perhaps the political part will stabilize following our national elections. *Both presidential candidates have been supporting a stronger U.S. military and, although we don't propose war mongering, eccentrics like Saddam may settle down if the U.S. assumes a stronger world posture.*

Finally, the mutual fund year ends October 31st. This is good news for the markets because gain/loss planning should be less of an issue and end of year window dressing should be complete. *The funds have an enormous influence on the markets (normally negative) and we should expect a return to normalcy by the end of this month*.

We think the economy has a good chance of experiencing a soft landing and that interest rates could be lower next year. Also, we believe that oil prices will come down as winter turns to spring. However, we also believe there will be a slowdown in corporate profits. The New Economy seems alive and well to us, but in our minds it is running a marathon, not a sprint. *We think investment success will be achieved if we focus on the longer timeframe*.

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