

Just Relax

In our very first issue of *fcNOTES* (December 30, 2001), we urged you not to consider buying stocks “until it is no longer possible to get the smell of investor disgust and dismay out of your clothing.” Now you know what we were talking about. Perhaps it’s not sticking to your clothing yet, but it’s definitely in the air.

Since our last newsletter (in which we once again reminded you to “remain bearish”), the Dow has slipped nearly 7%, the S&P has fallen 7.3%, and the Nasdaq has plummeted 9.5%.

It’s always darkest before the dawn, and if you are wondering how much darker it can get, we finally have some good news for you: Not much.

Notwithstanding all the gloom and doom in the news (which has only intensified since the announcement last week of the massive accounting fraud at WorldCom), it won’t take much more damage in stock prices to move us into the bullish camp, at least temporarily, for the first time in more than two years.

Crisis of Confidence

Remember our rule: by the time the media picks up on a trend, most of the danger (or opportunity) is already past. The fact that major mainstream television and print media are finally realizing that something is badly wrong with corporate America, with the stock market, and (possibly) with the entire U.S. economy suggests that much of the danger of owning stocks is behind us.

In the last issue of *fcNOTES* (May 31, 2002), we showed you the striking difference between the covers of magazines during the global financial crisis of 1998 (dark and foreboding) and those appearing on the newsstands this past spring and early summer (optimistic and reassuring).

In spite of the crisis of confidence among investors in the U.S. at the time, the fall of 1998 was about as good a time to buy stocks as history has ever presented (the Nasdaq surged 86% in 1999). But with the media celebrating the end of the recession and the beginning of the recovery, was the first half of 2002 a good time to buy stocks? Even if you don’t own any stocks, the answer is all around you.

Take the June 24 issue of *Fortune* magazine (which was on newsstands two weeks before the WorldCom story broke). The cover is black with blurry red lettering: “System Failure: Corporate America, we have a crisis.”



When it comes to your investments, this cover is more frightening than any that appeared last year after the terrorist attacks of 9/11.

And the story inside the magazine is scarier still: “Phony earnings, inflated revenues, conflicted Wall Street analysts, directors falling asleep at the switch—this isn’t a few bad apples we’re talking about here. This, my friends, is a systemic breakdown. Nearly every known check on corporate behavior—moral, regulatory, you name it—fell by the wayside, replaced by the stupendous greed that marked the end of the bubble. And that has created a crisis of investor confidence the likes of which hasn’t been seen since—well, the Great Depression.”

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Even television commercials are starting to reflect the *new* conventional wisdom – that “buy and hold” may not be such a great idea after all. The discount brokerage firm Charles Schwab has been running a new commercial touting its ability to – are you ready for this? – advise investors when to *sell* stocks: “There’s never been a better time for Charles Schwab... A way to help you decide what to sell as well as what to buy.”

Contrast this with the Schwab commercial that ran immediately following the post-9/11 market sell-off, in which Charles Schwab himself told a worried group of investors to “just relax.”

No one is telling investors to relax right now, and that’s why you finally can.

Nasdaq Composite Index (July 2001 – June 2002)



Are We There Yet?

Given the dramatic change in investor sentiment over the past month and the attention this is finally receiving in the media, is it possible that we have already reached a bottom in this bear market?

Some contrarian investors think so. Last week, in spite of the WorldCom announcement, both the S&P 500 and the Nasdaq Composite bounced off their respective September lows (see chart above), possibly forming what is referred to by market technicians as a “double bottom.”

While acknowledging that the market may have successfully “tested” its lows and can therefore continue to rise from here, we cannot emphasize enough to our readers that stocks are just as likely (and perhaps more likely) to continue falling over the next two months.

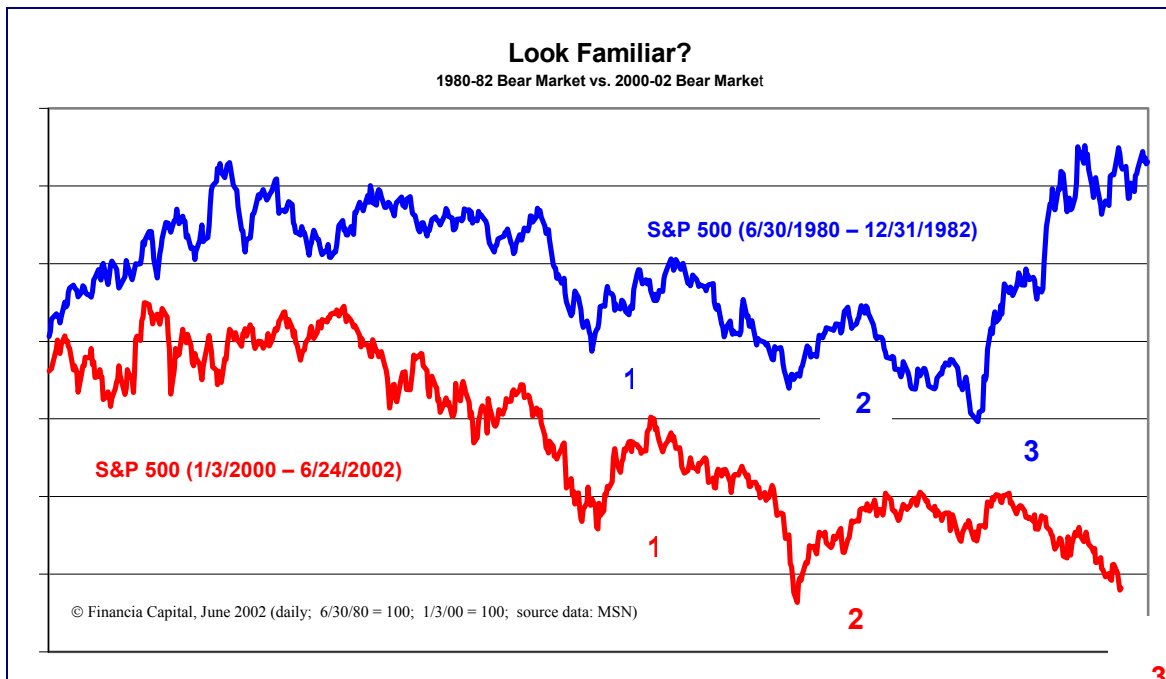
All the signs may be present to suggest that the end is near, but picking an absolute bottom or top in any market is next to impossible. How much investor disgust and panic is needed to end this thing? We will only know in retrospect.

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Hold On

So what's an investor to do? Our advice to those who are thinking about throwing in the towel and selling whatever stocks they still own is to hold on a little longer. The only thing that can make you feel worse than owning stocks throughout a bear market is selling at the bottom. Don't do it.

As difficult as it is to hold, much less buy, stocks when everyone around you is giving up hope, if you wait for hard evidence of a recovery in corporate earnings (and corporate ethics) before you invest new money, you are almost certain to miss the initial surge in prices that can occur at market bottoms. This bear market has borne a striking resemblance to the 1980-82 bear market (see chart below) which ended with an astonishing rally that wiped out nearly two years of losses in less than four months. Given how powerful the next bull market could be (in spite of what the media is telling you to expect), we believe that we are getting close to the point at which the risk of missing the start of the next market cycle exceeds the benefit of avoiding more losses in the very near future.



What about jumping back in and getting fully invested? You will probably do just fine over the next twelve months, but we are not recommending this course of action yet. As close as we may be to a bottom, we continue to maintain a net-short (i.e.—bearish) bias.

Why? Even a dying bear can inflict serious damage, and this one still shows some signs of life.

But make no mistake – the bear is dying.

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