

BY STEPHEN BRENNAN

Climbing a Wall of Worry

AS JULY COMES TO A CLOSE, I AM GOING to throw caution to the wind and make some exceptionally bold assumptions and predictions.

I believe that the stock market hit bottom at the end of July. The Dow Jones Industrial Average tested its 7,500-point level, the S&P 500 its 780-point level, the Nasdaq its 1,200-point level and the Philadelphia Semiconductor Index its 300-point support level. At their historical highs the Dow, S&P, Nasdaq and SOX were over 11,700, 1,500, 5,000 and 1,300 points, respectively. Their intraday low points represent declines of more than 35 percent for the Dow, 48 percent for the S&P 500, and 76 percent for the Nasdaq and semiconductors. These prices also represent critical support levels that I believe will hold and form the base for the new bull market I predicted in my last column.

There is an old Wall Street saying that bull markets climb a wall of worry. In the months ahead, I expect that we will hear continued worries over accounting scandals, a declining economy, fiscal budget deficits, and other problems such as terrorism and Iraq. In the semiconductor sector, I expect to hear pessimism about not only the rest of 2002, but also about 2003. This will likely reflect concerns about top-down drivers, like the economy, as well as worries over the push-out of next-generation device production due to the challenges at the 130/100 nm nodes. In all this gloom, however, consider the fact that if everybody knows about these problems, they are already priced into the stocks. Surprises are what move stocks, and extreme pessimism ensures that good news is more likely to be the surprise.

DÉJÀ VU ALL OVER AGAIN

In my fund's June client newsletter, we included a chart comparing the 2000 through 2002 bear market with the 1980-1982 bear market. The historical charts of the

S&P 500 illustrate the remarkable similarities between these two markets. Both begin with spiking tops before three rolling bottoms. They also have V-shaped bottoms, without the retesting or sideways movement many "experts" are currently predicting. In my last column, I alluded to this comparison by noting that the early 1980s bear market bottomed in August, and I indicated my expectation for a similar July to August bottom with the current market.

The similarities between these two markets, however, run deeper than mere price patterns. As this bear market developed and my fear of a double-dip recession emerged, I went back and looked at how the market responded to previous double-dip recessions. In 1982, we saw a strong second-quarter economic performance based on the strength of an

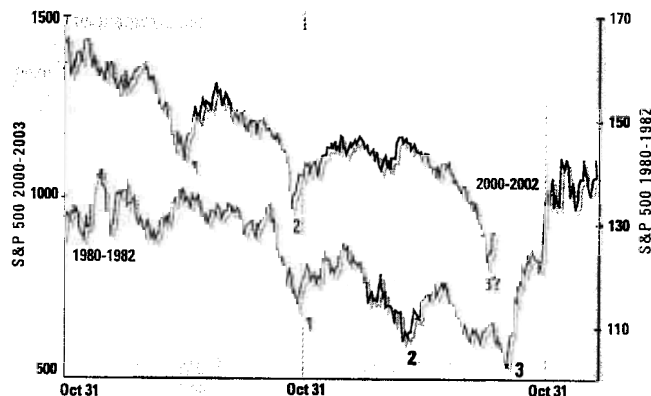
inventory rebuild, before that strength faded in a weaker-than-expected third quarter. Sound familiar? Yet 1983 proved to be a better year than anyone expected, and stocks moved higher in anticipation of this. I expect history is well on its way to a repeat performance with 2003.

SEMICONDUCTOR STOCKS

I believe that in the near-term, the worst is behind us for stocks, and that we have some healthy gains ahead. But remember, the stock market tends to lead the economy by about five months, so don't expect the business environment to improve anytime soon. I also still expect technology stocks to outperform, so an overweight in semiconductor stocks is fine – just don't go crazy. If you have too much tech exposure, use a rally to re-allocate to other areas of the market, but stay in stocks. ☺

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S&P 500 COMPARISON
2000-2002 Bear Market vs. 1980-1982 Bear Market



Source: Commodity Systems Inc.