

### Perception versus Reality



The cover of the May 6 issue of *Barron's* depicts a bull kicking a bear in the... you know where. The caption reads, "A surprising number of portfolio managers expect the market doldrums to end soon, with the Dow vaulting past 11,000 this year."

The title of the cover story is "Think Positive," and it reveals that, according to the *Barron's* 2002 spring Big Money poll, "bullish thoughts are alive and well among the nation's money managers." Indeed, 47% of the professional money managers surveyed remain optimistic about the near-term prospects for the U.S. stock market in spite of its abysmal performance of late (see "outlook" box below).

Hmmm... A bull kicking a bear. A major financial publication advising us to "think positive." A national survey showing bullish sentiment.

We can't think of better reasons to remain bearish.

In our January 31, 2002 newsletter, we advised our readers not to worry about another major terrorist attack any time soon because "by the time the media recognizes the danger, most of the danger will have passed."

The same is true on the flip side: by the time the media recognizes an opportunity, most of the opportunity will be gone. And that is the case right now for the stock market and, we fear, for our economy.

People always refuse to believe this. It seems simplistic. But it works, in bull markets as well as in bears.

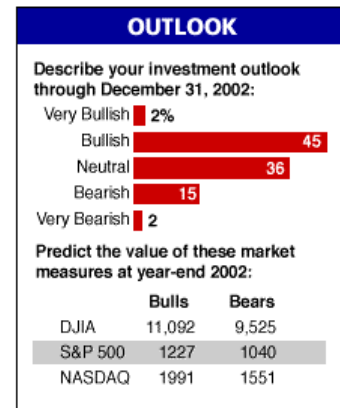
### Looking Back

In the fall of 1998, the extraordinary bull market of the 1990s seemed to be coming to an end.

The Asian financial crisis had begun in Thailand in July of 1997, and it soon spread to Korea, Indonesia, and other countries in the region. Stocks sold off in the United States, but by the end of 1997, the U.S. stock market was once again roaring ahead, oblivious to problems in Southeast Asia.

By the fall of 1998, however, it was clear that America was facing a very real global financial crisis. Adding to the dramatic flight of capital out of emerging market economies in Asia, Russia defaulted on its debt and the New York Fed had to step in to orchestrate a bailout of Long Term Capital Management. The media warned of an impending global recession that would surely spread to the U.S., and economists contemplated the prospect of bank runs on whole countries. As the U.S. stock market buckled, talk of a bear market was widespread.

There were real reasons to be scared back then, certainly better than the excuses being used today to "explain" the recent decline of stocks (Enron's deceptive reporting, revelations that Wall Street analysts knowingly misled investors to boost investment banking business, etc.).



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But all you had to do to figure out whether to buy or sell in the fall of 1998 was look at the magazine covers, which screamed warnings like “Global Risk” (*BusinessWeek*, October 12, 1998) and “Is the Boom Over?” (*Time*, September 9, 1998).

Those who understood the inverse relationship between media hype and the market bought stocks by the boatload in the fall of 1998 and enjoyed extraordinary returns in 1999.

## Looking Forward

Contrast magazine covers from that period with those on the newsstands during the first half of this year. We have already shown you the bear-kicking bull on the *Barron's* cover earlier this month. Take a look at the March 18 cover of *BusinessWeek*: “The Surprise Economy: Weak recession? Yes. Strong recovery? Quite possible.”

By October of 1998, the media had figured out that the world financial crisis was... well, a crisis. So most of the danger was past, and savvy investors were able to buy stocks with confidence at bargain prices.

Today, the media has figured out that the recession is over and that good times are just around the corner, both for the economy and the stock market.

Still feel like buying stocks?



## Rose-Colored Glasses

Magazine covers like these are reliable contrarian indicators, if you have the discipline to view them with an open mind. The reason so few people believe this is that they tend to block out anything that doesn't fit with their hopes (or fears) for the future. In other words, they see what they want to see.

For example, it is often said that when bears appear on the covers of magazines, the bear market is over. On March 26, 2001, as the stock market fell to levels that few had believed possible, a bear was featured on the cover of *Time*. “Ah, ha!” said many investors, “This is surely a sign that the bear market is coming to an end.”

Not so fast. The first sentence of the *Time* cover story was, “Let's start with some comforting news: a lot of stocks are doing well.”

We didn't need to read any further to know that this wasn't the kind of bear cover that marks the end of a decline. If anything, the story made us more bearish by pointing out all the great reasons to be optimistic about the economy and the stock market.



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This bear market will most likely end like every other bear market we have had. The *Barron's* Big Money poll will reveal growing pessimism among the professionals as the stock market makes new lows. Excuses will be made for the decline, such as continuing fallout from Enron and other firms with questionable accounting practices, more revelations about conflicts of interest among Wall Street analysts, or perhaps further turmoil in the Middle East and conflict between India and Pakistan.

## The Real Reason?

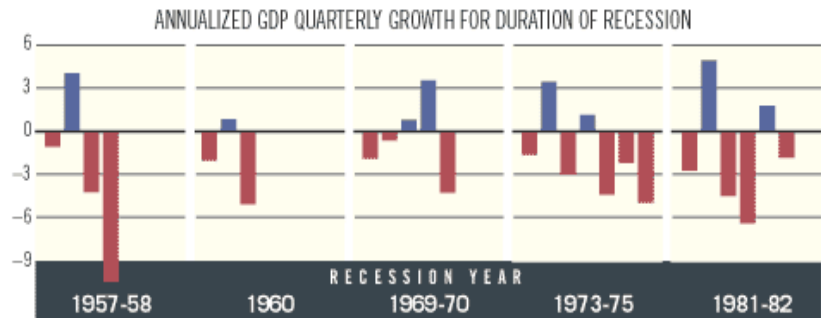
It is unlikely that any of the reasons given for the final leg down will be the real ones. After all, accounting scandals, corruption on Wall Street, and trouble in the Mid-East have been plastered all over the covers of magazines for several weeks. So these factors are already priced in.

What isn't priced in is the prospect of further weakening in the U.S. economy.

Stephen Brennan, our intrepid Strategic Analyst, writes the monthly Market Intelligence column for *Semiconductor Magazine* (find all his columns at <http://www.semi.org/web/wmagazine.nsf>, under "Market Watch"). In his March 2002 column ("Reality Check on Predictions"), Steve suggested that a double-dip recession might be in the cards: "Although most economists have predicted a recovery in the first quarter of 2002... I now believe the odds are very good that we will experience a double-dip recession." Today's news that factory orders rose 1.2% in April, consumer sentiment rose in May, and first-quarter productivity hit a 19-year high would seem to suggest otherwise, but the equity markets are not impressed. Since a rising stock market has been a leading indicator for past recoveries, this should give you pause.

## A HISTORY OF DOUBLE DIPS

*Five of the past seven recessions were interrupted by brief periods of growth followed by a continued slump*



Data: Commerce Dept., Morgan Stanley Dean Witter & Co.

Indeed, there is unanimous agreement among economists that the recession is behind us and that we are well into the recovery (and perhaps a strong recovery, given the first quarter annualized GDP number of 5.6%).

You would expect economists to know their history a little better.

Five out of the last seven recessions were so-called "double-dip" recessions, in which the economy experienced a quarter or two of growth (and sometimes strong growth) before sagging again. If you didn't know this, don't feel too bad; the media rarely mentions it.

That may change soon. If this recession adheres to the more common pattern, be prepared for the media to greet the news with increasingly gloomy predictions for the future.

Only then will we be able to say with any confidence that the stock market is bottoming out.

Sean Bill  
Managing Principal

Stephen Brennan  
Strategic Analyst

Ian Fraley  
Managing Principal

Please send comments to [fcNOTES@FinanciaCapital.com](mailto:fcNOTES@FinanciaCapital.com)

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