

OUTLOOK 2002

The past year has been a very difficult one, and we are glad to leave it behind. The terrorist attacks against the U.S. were tragic and will leave a lasting impact on most people. The economic and financial damage from the events of September 11 are less important than the tragic human loss, but are still huge. The combination of a global recession, the war on terrorism and extremely volatile markets have made investing an even more difficult task than normal.

As we look ahead to the year 2002 we note that rarely has there been such a divergence of opinion as to the investment future. On the positive side the U.S. is a very resilient economy and Americans are inherently optimistic. Monetary conditions are as bullish for equities as they have ever been and short-term interest rates are so low that we appear to be set up for a classic cyclical bull market.

On the negative side the geo-political situation is still very tense and the situations in India-Pakistan, Israel and Saudi Arabia may all de-stabilize and cause ripples throughout the world. Further, we are in a global recession brought on by supply excesses and deflation rather than the 6 previous recessions which were inflationary and brought on to quell demand excesses. In addition, the S&P500 is trading at 30 times operating earnings and even if earnings were to grow by an amazing 20% (which is being called for by some strategists) the forward price-to-earnings ratio would be a historically high 24. We also note that margin debt is still very high and the “certain” indices are in an “extremely speculative” phase (maybe investors didn’t learn anything about the tech bubble melt down). There is also the fact that even after the long bull market that U.S. consumers have experienced, there is continued deterioration in the family balance sheet, which is most worrisome.

Our conclusion is that we believe we are in a period very similar to 1966 to 1982. This period was characterized by a cyclical nature that drove the DJIA (Dow Jones Industrial Average Index) up to the 1000 level and then down to 600. The end result being that over that 14-year period the market achieved no gain. It was an era of “sector rotation” and one in which buy and hold or index investing was not profitable. Thus you should anticipate slightly higher turn over in your accounts and option trading will be very profitable as it is in more volatile environments.

In terms of fixed income, corporate bonds are the only “cheap” area and we will continue to hold more of these bonds than governments or provincials.

Myself, and all of us at Elysium, would like to take this opportunity to wish you and your families a very peaceful, healthy and prosperous New Year.

Ian Kalinowsky, CFA
President