# REVIEW & COMMENTARY
# $2^{ND}$ QUARTER 2003

**Bull market or just Bull**

The big question everyone now asks is whether the performance we have seen in the past quarter signals the last of the bear market. On one hand, you have the fears of deflation, a struggling economy, and lack lustre corporate profits. On the other hand, you have increased liquidity, historically low interest rates, unrelenting consumer spending (particularly housing) and a rising stock market.

As we have discussed before, stock markets are not always the best barometer of economic conditions. Rather, the yield curve has a much better track record of the economic future. With a positively sloped yield curve, the indication is that the economy will continue to gradually recover.

The U.S. government has done almost everything within its power to accelerate growth. The Federal Reserve has lowered interest rates, the Government has reduced taxes, allowed their currency to fall against most global comparatives and provided a scenario where oil prices could fall back to more economically stimulative levels (mid to low 20's). Imagine, all this in the year that precedes a Presidential election. Nothing like the prospects of re-election to get the present incumbent to turn his energies to the economy.

Despite all the evidence for both sides, one thing that continues to hold weight with traditional investors such as us is simply, supply and demand. Don Coxe, U.S. strategist for BMO Nesbitt, recently wrote about increased global liquidity. He claims that global liquidity levels are at all time highs. He concludes that this liquidity explains the rise in stock prices, particularly lower quality and speculative companies. While we endorse the idea of supply sending stocks higher, his conclusion that lower quality and more speculative (technology) issues are the prime benefactors is not as convincing, however, it may explain the recent move. The premise of lots of money chasing few alternatives is sound.

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If you look at the more traditional alternatives, equities hold long-term appeal though short-term valuations may be high. Interest rates are so low that cash provides a negative return after taxes and inflation. If interest rates are close to their low, thus bond prices at their high, mid to long term bond returns may, at best, provide a return similar to their coupon. Equities presently, it could be argued, are historically expensive but they always tend to be expensive at the end of the bear market as anticipation grows of an economic and earnings rebound. But two dominating statistics that play over and over in our mind is simply the amount of money on the sidelines, in cash and cash equivalents. There are trillions of dollars in cash and cash equivalents in North American capital markets. Add to that the liquidity that the U.S. is presently pumping into the system and it is hard for this money, given the alternatives, not to find its way into the equity markets.

Certainly this doesn't justify present equity levels or even further levels if earnings do not improve. However, it does justify, given all the risks, having a conservative portfolio that combines long term growth potential and current income. We have been singing the virtues of this investment philosophy for decades. The only thing that makes us nervous is everyone else is joining the chorus.

We have stated that the market bottomed a while ago. While we continue to believe we are correct, there is never any need to run after the bull. Markets never go up as fast as they go down. Well positioned, diversified portfolios will provide excellent long term results. That has been proven over time, it's not a bunch of bull.

Stodgell Investment Management Ltd.