

Though Hershey Park may be closed for the season, not all rollercoaster rides are necessarily over. The ups, downs, and turns of this year's stock market have certainly given the Great Bear (no pun intended!) a run for its money. Here's a quick review of the past several months.

Following a rather placid June, strong performance in the equities market during the months of July and August brought both the S & P 500 and the Nasdaq Composite stock indexes well into positive territory for the first time since the initial quarter of the year. Of the three broadly followed indexes, only the Dow Jones Industrial Average remained in the red for year to date returns as of August 31. Contributing to this upswing was the Fed halting its rate-tightening trend, combined with indications that the overall economy was cooling from its feverish pitch but still percolating along just fine.

But the investment markets are often fickle and what August had giveth, September taketh away. Market skittishness was renewed by concerns over everything from rising oil prices to weakness in the euro. Early October brought additional jitters from conflict in the Middle East and warnings from several firms that quarterly earnings growth would come in below previously projected levels. From our view, this last concern is an example of the short-sighted perspective that periodically infects traders and helps contribute to huge irrational swings in the market.

Follow the logic. The Federal Reserve sees overheating economic growth and the resulting potential inflationary pressures increasing at what they consider an alarming rate. The Fed's response? Begin incrementally raising interest rates to put the brakes on. Fast forward several months and what occurs? Some corporations report earnings growth rates that are less than originally projected and are subsequently punished by surprised traders. Maybe we're missing something here but the resulting reduction in earnings is pretty much a connect-the-dots scenario, being both intended and expected.

However, two factors are contributing to the market's hair triggered reaction to less than stellar earnings news from companies. Much of the bull market we've experienced has been driven by investor momentum. Since the market has recently lacked direction, there is a tendency to overreact to any information, negative or positive, lest one be left behind in the next big move. This bandwagon mentality contributes to heightened market volatility.

Second, the day of reckoning for many previously hyped Internet start-ups came during the year when investors finally recognized that an "E" in a company's Price/Earnings (P/E) ratio was indeed important. Many Internet stocks were trampled when investors recognized earnings would not occur anytime soon, if ever. The ripple of the broken dot.com bubble is still impacting well-established, large-cap firms sporting high P/E ratios. Having been burnt once, traders are fleeing at the first sign of lower-than-expected earnings.

What do we see moving forward? At present, the overall domestic economy continues to move along with few signs of stagnation or significant inflationary pressures. This bodes well for the markets in general. But segments of the market are still overvalued and investor sentiment is increasingly negative. Combine that with a close presidential race and the other factors mentioned previously and you have a recipe for continuing day to day volatility and downward pressure.

Will the last several months of 2000 bring some rally in the stock market? Perhaps, but there is not consensus that the bottom has yet been reached for all parts of the market. Until that happens, upward moves may tend to be sporadic and temporary.

Outlined below are a few strategies currently being used to help build and preserve your assets. While each client situation is unique and addressed accordingly, certain guiding themes apply throughout.

- We continue to emphasize equity diversification; by industry, management style, and market sector. In 1999, we shaded overall portfolio percentages toward managers with a “growth” style orientation and typically increased technology and service sector weightings slightly above benchmark levels, rewarding investors because of this area’s high performance relative to the market last year.

However, earlier this year we started shifting more weight toward top tier “value” style managers. This helped temper overall portfolio volatility in the downward market, with several “value” holdings actually appreciating nicely during the past six months. Presently, we typically maintain an approximate 50/50 portfolio weighting of “growth” and “value” styles in most equity portfolios.

Moving forward, we will shift additional exposure to “value” style managers, if traditional “value” business sectors continue to show appreciation potential and downside protection relative to “growth” alternatives.

- Our general bias is always toward larger cap stocks. Starting in the last quarter of 1999, we gradually increased exposure to mid-cap and small-cap managers within overall investment policy limits; again rewarding investors on the upside move of the market.

However, mid/small cap growth funds tend to fluctuate in volatile times and, as suggested in our previous Investor’s Update, these were the first holdings scaled back when the markets began deteriorating in late March and April.

Only in July and August did we begin tentatively moving mid and small cap exposure back towards mid point range for our clientele focusing on appreciation. We’ve tended to balance mid-cap exposure by equally weighting management styles, as compared to our leaning toward “growth” in this category last year. However, we have halted new additions in this area and will again pare positions if market fundamentals continue to turn negative.

- In balanced portfolios containing equities and fixed income, we presently choose to be at or below mid-point equity exposure, with the possibility of additional moves toward the lower end of the policy range.

Typically, we phase into the desired investment exposure percentage when presented with large initial cash positions. This provides the benefit of averaging purchase prices as core stock and bond positions are being built. We are phasing in new equity purchases even more cautiously than normal in this current volatile environment.

- We use individual bonds to better control maturity and issue quality when maintaining large fixed income positions for clientele. Often, one objective for the bond portion of a portfolio is tempering volatility. This goal is supported by our utilization of short to mid term maturity investment-grade bonds. Currently, the maximum maturity considered is approximately seven years. Our emphasis of investment grade bonds remains constant.

Also included with this Investment Update is a recent article I’d written reminding readers of some of the basics that are particularly apropos when the market is being difficult: understand the details of any investment you make and be wary of deals that sound too good to be true.

I hope this brief overview was helpful in outlining a few of the ways we continue to respond to this challenging market on your behalf. We indeed value your business and our ongoing relationship. As always, please don’t hesitate to call with any questions or if we can be of additional service.

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