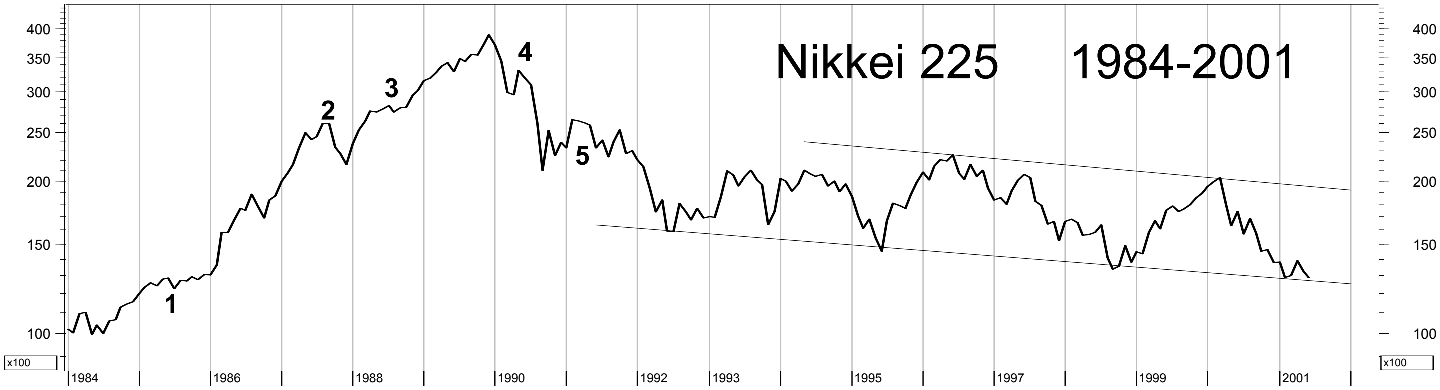
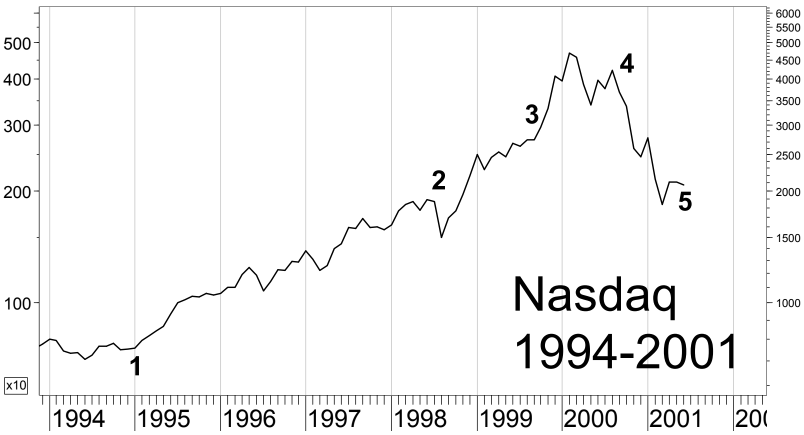
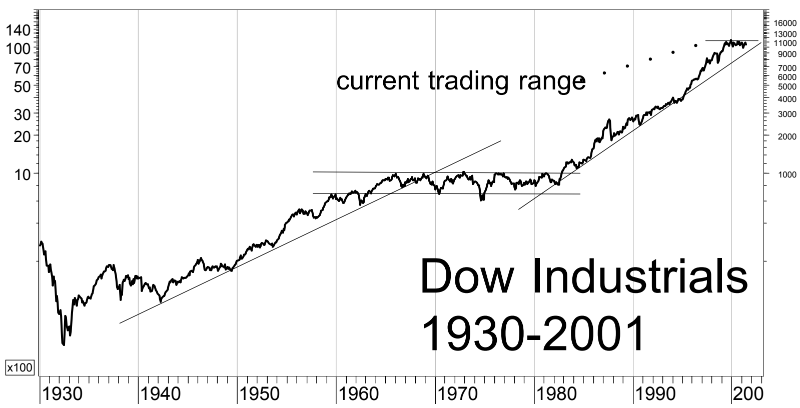
Will Market History Repeat Itself?





We have lived through a period of exceptional market behavior. In August, 1982 the country was mired in recession, unemployment had reached the highest levels since the depression, analysts were pessimistic about corporate earnings and the Dow Industrials were lower than they had been sixteen years previously even though rampant inflation during the 1970's had eroded the real value of stock portfolios. The dividend yield on the S&P 500 was 6% and the P/E ratio fell below 8.0. In these conditions the market began a long advance that lasted until the start of 2000.



Now, even with a serious decline behind us, the market is at a different extreme. Dividend yields, at under 1.3%, are at historical lows. The P/E ratio of the S&P 500 at 27 exceeds valuations even at their heights of the 1920's. Analysts' projections of earnings growth, at record, incredible levels of 25% per year estimated in mid-2000, have now plunged to expected annual growth of 5.3%, lower than any estimate since 1980. Where do we go from here?

The charts on this page, although of course not definitive, may offer some relevant historical analogies that suggest we may be in for several years of consolidation. Japan in the 1980's experienced its own market bubble (top chart). We have identified five stages of the evolution of the Nikkei: 1) The initial take off after a flat year. 2) A sharp correction (the crash of 1987) from which the market quickly recovered. 3) The final, explosive advance. 4) A failed attempt to reach the old high. 5) Another failed rally after significant retracement that ultimately led to a trading range that persists to this day. We have identified what appear to be five analogous stages in the Nasdaq's rally in the second chart.

The bottom of the three charts shows the long term history of the Dow Industrials. After the 1942-1966 secular bull market, the Dow entered a trading range that lasted until 1982, as indicated by the parallel horizontal lines. With the wisdom of hindsight, one could say that the Dow has been in a trading range from 10,000-11,300 for most of the past two years, during which time there has been no overall appreciation in price. During the 1966-1982 stagnation, dividend income at least provided significant cash return to long term investors. At current dividend levels, this would not be the case. Stocks may well prove to be more attractive as trading vehicles in the coming decade than as one-decision, buy and hold investments.

Marvin Appel and Glenn Gortler