SPECIAL COMMUNICATION #5

OCTOBER 8, 2001

USE STRENGTH TO RESTRUCTURE PORTFOLIOS

- Last week was a good week for stocks. Not only did most of the major indexes rise almost to pre September 11th levels, but did so in the face of earnings warnings and weak economic data, something the market has not been able to do for some time. Investors chose instead to focus on positive news such as the massive amount on policy stimulation coming from the Fed (rate cuts and liquidity injections) and the proposed fiscal stimulus from the government. The commitment of policy makers is one of several factors that we believe are fundamental to restoring consumer confidence, and that we hope will ultimately succeed in turning the economy around.

- From a strategic point of view, we see the end of the bear market playing out in the coming months as the market prices in a full fledged recession and then starts to forecast a recovery. Our recommendation continues to be to allocate **gradually** into equities, especially when stocks get oversold and or valuations get cheap. This, of course, if portfolios are not already at preferred/required equity allocation levels.

- Tactically, the inclination of our advisers has been to avoid chasing the rallies. If we were on a more solid technical footing, investment managers might be more inclined to jump in, but technically the recent rally should probably be regarded as the correction of a very oversold condition. We must not forget that the primary trend is down. We will probably see another low at or above the recent low followed by a meaningful break above the September 11th level to get the intermediate trend back to positive.

- From a valuation standpoint, we reiterate our view that stocks are good long-term value in the low 900's on the S&P 500, but we are already 11% above the lows made on September 21st. Also we need to remember that some kind of future terrorist attack is a likely if not inevitable part of a war on terrorism.

- So what to do? Just as two weeks ago, we believed some great companies got to very attractive levels, so we believe this rally will give managers the chance to get out of some stocks that they don't want to own long term, so we should expect some transacting in the coming weeks. For those investors who are still very overweight in technology stocks and funds, we recommend using the tremendous rally in NASDAQ to diversify and become more balanced. Finally, we have just entered the last quarter of the calendar year, signaling tax planning for our taxable clients. We will be contacting you in order to schedule strategy sessions.

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A STRICTLY TECHNICAL PERSPECTIVE – OVERSOLD RALLY STALLING?

The stock market staged an impressive rally over the past two weeks, after one of its worst weeks ever following the week of September 11th. The S&P 500 rose 11% from its low to the high made last Thursday. The extreme degree of oversold readings seen in many technical market indicators suggested a rally should be forthcoming.

To raise confidence of improvement in the technical picture, technicians would want to see the S&P 500 and the NASDAQ rise with conviction above lows made earlier this year – 1100 and 1620 respectively – and the Dow Industrial Average move above 9000, taking it back into its 2 year trading range. Many technical market indicators, which had been extremely oversold just two weeks earlier, have reverted back to more normal ranges and in some cases have reached overbought territory.

A pullback after a strong rally such as we've seen in the past two weeks is considered entirely normal, and many believe that in some ways the market is starting to feel like it did in June 2001, following the rally off of the market low made in late March / early April of this year. The magnitude of the rally's retracement could be as mild as one-third, as severe as two-thirds, or it could be a more typical one-half retracement. These levels have historically been areas a correction would hold at. To increase the probability that the market has seen its lows, technicians are looking for a pullback to one of these retracement levels, possibly in tandem with more oversold readings from technical market indicators, followed by a renewed rally taking the market above the highs made last week. A drop below the two-third retracement levels – roughly 1000 for the S&P 500, 8530 for the Dow and 1480 for the Nasdaq – would be a warning that the September lows could be retested or lower lows could follow.

Because the market remains in a primary bear market trend, technicians regard rallies with some skepticism. Buying stocks when others are selling is favored and the market is oversold, as a more appropriate strategy when trying to finesse the end of a bear market. When the intermediate trend starts to improve, one might become more amenable to continuing to buy during rallies.

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