

3rd quarter of 2002.

As you are well aware of, the second quarter has been another dismal quarter for stock investors. All the major market indexes went down for each of the last three months. For the quarter as a whole, S&P 500 lost 17.27%, NASDAQ lost 19.90%, and Dow Jones Industrial Average lost 17.44%. This is the worst quarterly performance since the third quarter of 1987. The sell-off was no longer limited to technology stocks. Almost all sectors of stocks including energy, financial services, utilities, consumer products went down. Stocks in Japan are in the same level as in June of 1983. The European stock market went down further than in the U.S. market.

What are the factors driving down the stock prices in the second quarter? The following is a list of reasons:

- There are now worries on a possible double-dip recession the next year. While corporate spending has some signs of growth lately, consumer spending is slowing down due to huge losses in the stock market, weak labor market, terrorist threats, and the talk of war against Iraq.
- The possible war against Iraq makes consumers and business reluctant to boost spending. The higher oil price is hurting both consumers and businesses.
- Although there have been no new revelations of major scandals since July, the accounting worries still linger and it takes time and a lot of reforms to restore investor confidence.

It is impossible to know the psychology of investors in moving the stock market on daily basis. The following is a list of reasons for cautious optimism in stock investments over the next few years:

- While corporate profits are still weak, they are increasing. The increases in productivity will help recovery in corporate profits down the road.
- Low interest rates, strong housing market, increase in disposable income, and lower taxes will continue to support the consumer spending.
- Stocks are oversold and the valuation is very low. Once the investors become a little less risk averse, stock prices should go higher.

While I am cautiously optimistic for stocks over the next few years, a sustainable bull market will not come unless the following conditions are satisfied: (1) corporate profits increase systematically; and (2) investor confidence in corporate governance is restored. So we have at least a few quarters of very volatile markets ahead of us. Since nobody can really time the market, the best strategy would be to patiently ride out the bear markets.