



“I am pleased to report that fire damage to the ship has been comparatively light.”

Rear Admiral Adolphus Andrews, Third Naval District, New York. February 9, 1942

The French ocean liner Normandie was reported to be the most beautiful ship ever built. It was the first ship more than a thousand feet long and fast enough to hold the Atlantic speed record for years. She was built in 1932 and launched in 1935. The décor was an art deco masterpiece with a three story dining hall the size of a football field. Normandie sailed the Atlantic for only a few years before World War II broke out, never making a profit. On her last voyage there were fears that a German submarine would sink her so the French government ordered her tied up in New York harbor for the duration of the War. When the United States entered the war in 1941, Normandie was seized for conversion to a troop ship.

During conversion, a welder's torch set fire to a pile of life preservers in the hold. The French fire hose fittings had been replaced to U. S. standards but the hoses had not been replaced so there was no way to control the fire at the source. Dockside pumps were available but the hoses were too short to reach the fire. New York City fireboats were called in to spray water on the boat to prevent the fire from spreading to the docks. It's not often the firemen get to work on a ship so they attacked the job with great gusto. Since the hull of the ship had been gutted and the ballast removed, water poured on the upper decks made the ship top heavy and it started to list away from the dock. The fire boats were ordered to stop pouring water on the fire to prevent Normandie from capsizing but the crews were on overtime, earning extra money the longer they worked. They had no incentive to stop and eventually Normandie rolled on its side. It wasn't much of a fire but the results were an unexpected disaster. The ship eventually was cut up and sold for scrap after the end of the war.



This story is a perfect example of government trying to be helpful but making a mess in the process. It is exactly like the Federal Reserve in its current inflation fighting mode. For eighteen months the Fed has been fighting a minor bout of inflation by raising interest rates, the only fire boats at its command. For nine of those months, nothing happened so the Fed continued to pour water on a small fire. Even as the economy started to roll over, the Fed continued with its policy of high interest rates, ignoring signs that the cure was worse than the disease. The Fed, it seems, has forgotten one of the most basic rules in economics.

An expansion can always be stopped and a contraction process started by a restriction of credit by the banks. A contraction, however, cannot always be ended promptly merely by making credit cheap and plentiful. *(Prosperity and Depression, Gottfried Haberler, Atheneum, 1962, p378.)*

As I write this, markets are down again, today and for the year. The best performing, and most watched, index is the Dow Jones which is off “only” seven per cent for the year. The Nasdaq composite, continuing last years' slide, is down more than twenty per cent. If you invested a dollar on January 2, you have less than eighty cents today. Stocks that sold for hundreds of dollars a share a year ago are now selling at hat size prices and the hat size prices are now drill bit size prices. Anyone who bought a stock for \$75 a share that is now selling for \$5 has a loss.

Forget that nonsense that it isn't a loss until I sell. If the remaining \$5 is put in a bank at 4% annual interest, you will get back to \$75 in only seventy-five years.

You can't read the papers without seeing gloom and doom.

"While stocks don't always predict recessions, perhaps they will this time," said Steve Shobin, technical analyst at Lehman Brothers. "With the decline in stocks and the relative stability in the bond market we may be starting to really feel the ax of the Fed's interest-rate increases."

Adding to the market's jitters, one of the last bulls at a major brokerage firm took a rather bearish turn in a morning market conference call. Byron Wien, market strategist for Morgan Stanley, told clients that he was increasing the cash position in his stock portfolio from 3% to 15% .

Amazingly, these comments are from the November 22, 1994 edition of the *Wall Street Journal*. We never did get that recession. Here are more quotes from a few years ago.

But in a new blow, Nokia [cellular telephones] cautioned investors that profit during this year's first half will be "significantly lower than the previous year," largely because of continued weakness in U. S. mobile-phone demand. That bleak prospect sent the company's stock plunging 8.8% . . . LSI Logic acknowledged it had thought the PC inventory problem was already behind it and said the market situation is too murky to enable it to say how fast the company will grow this year. (*WSJ*, February 29, 1996)

In a wrenching blow to the aging bull market, the Dow Jones Industrial Average posted its worst one-day point loss ever, despite two shutdowns of stock trading designed to stanch investor panic . . . But as grim as the numbers were, this wasn't a crash. The Dow Industrials dropped 7.18% yesterday, making it the 12th-worst one-day fall, in percentage terms, in the history of the average . . . (*WSJ*, October 28, 1997)

Tokyo's main stock index sank 3% to end near a six-year low. Everyone in the world wants their money back," said David Berry, a bank analyst at Keefe, Bruyette & Woods Inc. in New York. "It's like there's been a global margin call." (*WSJ*, August 28, 1998)

In the past seven years we have gone through a meltdown in Mexico, auto rebates to stimulate demand, an oversupply situation in cell phones and personal computers, a Russian economic crisis and a bout of "Asian flu" that hurt the world economy. In October 1997 the crisis was so bad and the market crash so severe that the New York Stock Exchange stopped trading twice in the same session. Each time we thought we were seeing the end of the American economy as we know it, but the markets absorbed the information and moved higher several months later. Most people forget about these catastrophes because we are too caught up in current events. We are accustomed to watching life's problems solved in a one-hour television program and have had our attention spans shortened to meet the needs of TV. And we've been brainwashed by the catchy political phrase "the greatest eight years in U. S. economic history." Repeat something often enough and people begin to believe it. It was a choppy decade and Wall Street, the real one and the economic one, are full of pot holes that are difficult - no, impossible - to avoid. We have survived every crisis so far, and subsequently moved on, and up.

This cycle is no different. I know we are near the bottom of this bear market because the talking heads on TV have taken their shows to the streets. Asking some spud who doesn't know which end of his baseball hat is the front what he thinks of the stock market is hardly helpful to the process. We are told to buy low and sell high. Well, it's low, or at least much lower than a few months ago. Buying and owning stocks is always risky but to profit later, we have to assume some risk today.

There were many forecasts this week about the magnitude of the interest rate cuts we should expect when the Fed meets on Tuesday, March 20. While any cut would be welcome, the markets this last week seem to be telling us that the cut should be bigger rather than smaller. In my opinion, the Fed is behind the economy and must get back in front before the economic boat rolls over. Back in 1974, then Fed Chairman Arthur Burns refused to lower rates in the face of a faltering economy because he believed the markets would view his action as capitulation, a “re-inflation” so to speak. Alan Greenspan was in the Ford Administration and watched as the Fed made a bad situation worse. I wonder if he remembers.

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