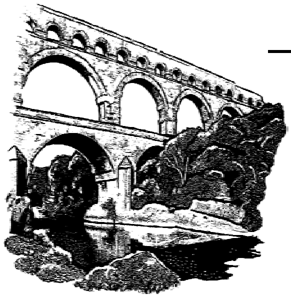

Stanley E. Rulapaugh, CFA **March 26, 2003**

> In light of the unusually large uncertainties clouding the geopolitical situation in the short run and their apparent effects on economic decision making, the [Federal Open Market] Committee does not believe it can usefully characterize the current balance of risks with respect to the prospects for its long-run goals of price stability and sustainable economic growth. Rather, the Committee decided to refrain from making that determination until some of those uncertainties abate. In the current circumstances, heightened surveillance is particularly informative.
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> Press release of the Federal Open Market Committee, March 18, 2003

I know that you had to read that twice and you still aren't sure what the paragraph means. First of all, it is a policy statement from the Federal Reserve's Committee that sets monetary policy. Some economists believe that monetary policy is <u>the</u> most important factor affecting the future growth of the economy. If that is true, then we should go through the opening statement again.

There are "large uncertainties" - risks - in the world that affect decisions. OK. The FOMC can't decide which of those risks is key to making policy decisions. OK. So the Committee decided not to make any decisions until "those uncertainties abate." OK. "In the current circumstances, heightened surveillance is particularly informative." Punt. Frankly, I don't know what this means. The "surveillance" itself is informative? Or the information derived from the surveillance is informative? Or does the FOMC mean to say it will be more vigilant? This is the most meaningless drivel I have ever seen from a government institution.

Anyone who has watched Alan Greenspan testify knows his objective is not to clarify the current situation. He appears in front of Congress because he must by law, not because he wants to answer silly questions from an uninformed Congress. In past letters I have taken shots at the Fed because of their delusion that the economy can be controlled. Maybe "fine tuned" is a better description. Back on March 19, 2001, I wrote, "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." In March 2001 the prime rate, the rate charged the best bank borrowers, was 8.5%. This was a full year <u>after</u> the peak in the stock market. The Fed panicked and six months later, the prime rate was down to 5%. (Today it is 4.25%.) Too little, too late.

Everyone now knows we are in the middle of a multi year recession. Prior to the March 18 meeting many observers thought the Fed would lower interest rates again, even though rates are at forty-year lows. It didn't happen. The Fed's own internet page states, "The Committee's actions on interest rates are undertaken to achieve the maximum rate of economic growth consistent with price stability and moderate long-term interest rates." Monetary authorities are expected to provide guidance to the business community. Instead we get equivocation. There is nothing in the Fed's March 18 pronouncement that would inspire confidence or make a business owner or manager want to make a long-term investment in the business. Without confidence, there will be no investment.

While all of this sounds very pessimistic, we need to remember how bad the economy was twenty years ago. Back then, Paul Volker was chairman or the Federal Reserve Board. When Mr. Volker took the job in August 1979, he inherited an inflationary economy with investors chasing gold, real estate and other tangibles to get away from paper money which was depreciating rapidly. Mr. Volker changed the Fed's focus from interest rates to the money supply, creating a shortage of money and a 20.5% prime rate in 1981. The vicious recession of 1980 - 1982 saw unemployment peak at 10.8%. It finally came to an end and we had a sharp recovery in 1983-1984. We went into another recession in 1990-1991 with unemployment greater than 7%. As bad as some folks claim things are today, unemployment is still only 6%. It is also important to remember at the start of the eighteen-year bull market in stocks and bonds (1982 to 2000), we didn't know it was going to be an eighteen-year bull market. Fourteen years into it, the public jumped in. We need to remember that it didn't go straight up (recall The Crash of 1987?) but it was up enough to make lots of folks wealthy. Those who did get wealthy were those who held their stocks through the tough times. Often the best investment opportunities occur when there seems there will be no end to the carnage, when pessimism is at its peak. Investors who did buy or stay the course were far better off five years and ten years later than those who jumped in and out of the market.

I suppose it is necessary to say something about the war and its impact on portfolios. We all see the same jittery pixilated TV shots of the battlefield and think we are informed. Frankly, the only people who really know what is going on are in a tent in Qatar and even they admit they can't know everything. As I write this, we are six days into the war and the *Washington Post* is already calling for a change in strategy. Like the *Post* knows what the strategy is. Isn't that the same outfit that called the Afghanistan campaign a "quagmire" only a few days into the conflict? The best line I heard from one analyst was that the first group to panic in this Iraq war was the press.

I turn the TV on at 6:00 a.m. and off at 11:00 p.m.. It goes with the job. Most of the day the set is on CNBC with the stock market scroll going across the bottom of the screen. Periodically I switch to MSNBC and FOX News just for a change of pace. Once I turned on an old Errol Flynn pirate movie just before going to lunch with a friend. When he walked in, the pirates were flogging their prisoners. He asked what I was watching and I told him "the market."

The mix of the CNBC, MSNBC and FOX provides a necessary balance. I won't watch CNN or the major networks, especially CBS. CBS has too long a history of making up the news, most recently Dan Rather's use of an actor to impersonate Saddam Hussein's interpreter. (Remember the exploding pickup truck incident?) After a while I don't hear or see reporting. I hear and see editorializing in the guise of reporting. I am very sensitive to the adjectives and inflammatory words used. Listen and you will hear many "Are you still bombing civilians?" questions during White House press conferences. My favorite so far? "Do you think the President prepared the people adequately for a long, drawn-out conflict?" On the sixth day? Pay attention to what is asked and how it is asked. Reporters interviewing a person with an opposing view will interrupt. If the answers aren't as expected, the reporter will get hostile or cut the interview short. If the answers are as expected, the reporter will ask the same question several times to make the point.

U. S. reporters aren't the only ones manipulating the audience. You may recall this week's news footage of the downed Apache helicopter. I believe it was taken by Al-Jazeera news. The opening few seconds show a group of farmers standing by the helicopter. The man in the middle holds a microphone, looks at the camera, and then tells the farmers to jump up and down. They do, and the reporter moves out of the shot toward the camera. With this footage on all day, you really start to watch. A photo of the "triumphant" farmers appeared on the front page of the *Arizona Republic* Tuesday with the caption "Iraqis celebrate Monday in front of a downed U. S. Apache helicopter in southern Iraq." Linking the tape with the photo, the celebration started when the reporter told them to celebrate.

Whenever I read the *Arizona Republic*, I read the headline and then read the fine print to learn the source of the article. In one section the *Republic* used articles from Associated Press, *USA Today*, *Los Angeles Times, Washington Post, Cox News Service, New York Times,* and Gannett News Service. If you know, for example, the *New York Times* editorial page is liberal and the *Wall Street Journal* editorial page is conservative, what you see in stories posted by their news services is likely to carry a similar bias in reporting. Once a position is taken, the objective changes from reporting the news to making sure the paper's position is supported by the headlines and the stories. Consider these two headlines: "THOUSANDS MARCH FOR PEACE" and "THOUSANDS MARCH FOR PEACE. MILLIONS DON'T." Same facts but an entirely different focus. I'm not saying this is either good or bad. It just exists and it is true of print and radio and TV. Today's audience needs to be very cautious and know the source and bias of every story.

The news and how it is reported will drive stock prices up and down randomly until we get to the end of this war. Today's stock price may have nothing to do with a stock's value. Price is an accident of time. Value is persistent. It makes no sense to sell Clorox stock or buy Home Depot stock because of news from Iraq. Let's keep focused on the reason we own companies and not on current events.

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