

These are the times that try men's souls.

Thomas Paine, *The American Crisis No. I*, December 23, 1776

The last two weeks of the quarter must have been scripted by Hollywood. It has been one cliffhanger after another. The big GE/Honeywell deal collapsed. Corporate earnings warnings were daily events. The Fed acted as the economy weakened. Oil prices continued their drop and the computers at the Nasdaq stopped at a critical moment. Even good news for Microsoft from the Appeals Court was tempered by reality.

Regulators in Europe rejected General Electric's proposal to acquire Honeywell, sending Honeywell stock back to pre-acquisition price levels. When GE tried to resurrect the deal, Honeywell went up a few points. Europe said no and Honeywell went down. GE reportedly countered with another offer and Honeywell went up only to fall when the rumors were false. Then Honeywell asked GE to lower the offering price but GE rejected the offer. It's off and Honeywell continues to sink.

Other stocks in the news included Merck, the large pharmaceutical manufacturer, and Walgreen, the leading drug store chain. Both said earnings would not be up to expectations so both dropped several points in a day. They weren't alone in disappointing. Delta Airlines, McDonald's, Proctor & Gamble and almost a thousand other companies have warned that earnings would be flat or down.

This follows the miserable first quarter when a thousand companies warned of poor earnings. Nortel

Networks won the prize, however, announcing a second quarter loss of more than \$19 Billion. Most of that was due to bad "investments" Nortel made during the internet bubble that must be written off. Some companies are resorting to unusual ways to meet their earnings estimates. Sun Microsystems, for example, told all 43,000 employees to take the July 4 week off without pay. Lots of people are out of work, permanently, particularly in the high technology area and layoffs are in the news every day. Nortel, mentioned earlier, expects to let 30,000 go to save cash.



Microsoft was another company in the news. The stock started to soar a few minutes before the Federal Appeals Court announced its reversal of the breakup decision but trading in the stock was halted. It probably would have been up \$20 if the halt hadn't been imposed. For two hours, while the talking heads on all the channels offered instant analysis, nothing happened. The longer the halt was in place, the more reasoned the enthusiasm. Yes, the company was guilty as a monopolizer and did use its power illegally, but at least the company won't be broken up. And the judge in the original trial was found to be biased against Microsoft so they won't have to face him again. But when trading resumed without a fanfare, Microsoft stock added only \$1.60 which isn't much for a decision this big. We won't know until all the appeals are exhausted what the penalty will be for exercising monopoly power so it increases the uncertainty of a Microsoft investment.

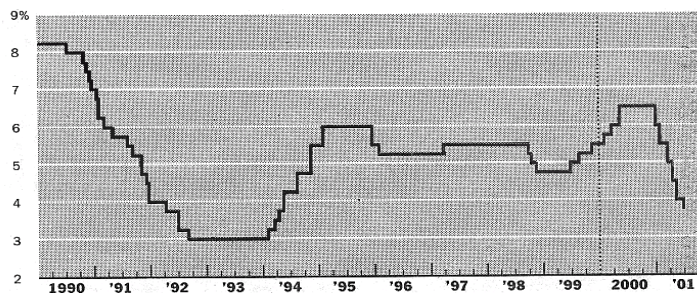
Another big story is the Fed and Alan Greenspan's testimony before Congress on June 20. Yes, the quality of loans at banks has deteriorated but that won't stop the Fed from lowering rates to help those same borrowers borrow more or repay what they owe. In the final analysis, it was another in a long string of Mr. Greenspan's "Wonderbra" speeches - uplifting, supportive, but without much there. Last week the Fed lowered short-term interest rates for the sixth time this year by .25% for a total of 2.75% since January. The theory is that lower rates will stimulate the economy and/or stave

off a recession. The .25% reduction after all those .50% reductions reminded me of Lucy yanking the football away from Charlie Brown. Even with all the rate cuts, the popular indexes are lower now than at the first of the year. Investors are getting discouraged and impatient.

The Federal Reserve left the door open for additional rate cuts at their meetings later this year. They seem to be less concerned with inflation now and more concerned with the recession they caused. The chart at the right, from the June 28 *Wall Street Journal*, shows Fed action on the Fed funds target since 1990.

(Their new motto seems to be “We like to be busy.”) Take ‘em down, run ‘em up, etc. We

are back where we were in 1993. Recent action brought down short rates but long rates are up since the beginning of the year. At some point, however, lower short rates will get the economy moving again.



Meanwhile, shorthand definitions of “recession” are two consecutive quarters of negative growth in Gross Domestic Product when my neighbor is out of work. It’s a depression when I’m out of work. The real definition of a recession from the National Bureau of Economic Research [NBER] is a “significant decline in [economic] activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income and trade.” Since the data used to determine the “significant decline” can be months old and subject to revision, the recession could be over before the NBER decides we have one. Even though the industrial economy has been weak for months, the NBER’s Business Cycle Dating Committee had not met as recently as June 18, 2001. Evidently the committee doesn’t think this downturn is bad enough yet to merit a meeting.

The other big story this quarter is the demise of the “energy crisis” that was so prominent not too many weeks ago. Oil and natural gas are both plentiful enough that inventories are building. A slowing economy requires less of both commodities. Several refineries are running again after being down for routine maintenance and consumers are more cautious with their consumption when prices are high. Unfortunately, the drop in energy prices now masks our vulnerability to a really hot summer or a cold winter. With these lower prices, refineries may not get built and the urgent need to build pipelines and electric transmission towers seems to be gone. It is a classic case of not needing to fix the roof now that the rain has stopped. Oil, gas, and oil service stocks have all suffered with this price pullback. I think it is a temporary situation and we really do need to drill and build now that we have had a reprieve. We aren’t going to be this lucky forever.

The final insult this quarter was the meltdown of the Nasdaq computers in the last two hours of the last day of the quarter. According to the July 1 *Barron’s*, newspapers and suppliers of market prices are drawing pricing information from wherever they can get it so it is possible prices in *The Wall Street Journal* may differ from those in *The New York Times*. (On Monday, July 2, they were still adjusting Friday’s closing prices.) What a mess and all because someone pushed the wrong button.

Thomas Paine is right even after 225 years: These are the times that try men’s souls. Happy July 4!

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