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# **THE PETE ANDRESEN INVESTMENT NEWS ANDRESEN & ASSOCIATES**

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## **2003: THE WORLD THIS YEAR**

*As a tradition at Andresen and Associates, we choose to mark the Asian New Year with a small gift of money to symbolize our continuing wish for your prosperity. This year's choice of currency is a bit controversial. Yet, at the same time, it would be disingenuous to select any other. In the final analysis, the whole world is waiting on Iraq.*

2003 is shaping up to be a pivotal year. It is entirely possible that this will be a challenging year filled with hardship and still more declining stock markets. On the other hand it is entirely possible that this will be a year when the whole US economy finally begins to genuinely recover, or possibly even leaps forward. A year in which the S&P 500 declines 15% is a possibility. Historically, the S&P 500 is more likely to go UP 15%.

2002 was the third year in a row in which we experienced declining financial markets. At one point late in the year, the NASDAQ was down as much as 85% from its 2000 high. In the broader stock markets such as the S&P 500 Index, the multi-year carnage was not as drastic, although that was small consolation if you were invested.

We begin 2003 with a large iceberg of bad economic data towering over us, and with the looming prospect of an imminent war with Iraq. Setting aside the profound global tragedy that might result from such a conflict, what happens to your portfolio depends on what happens during the war. There is an entire spectrum of possible outcomes from any war in which we might engage.

The most extreme prediction has Iraq engaging in a proactive war against Israel, using weapons of mass destruction. The least unpleasant outcome includes Saddam Hussein accepting a very large bribe from Saudi Arabia, receiving an amnesty from the UN, and departing Iraq for a peaceful retirement in Riyadh with a "60 Minutes" interview thrown in for dessert. Allied casualties would be nonexistent and there would be little or no military action in Iraq.

In other words, even the experts don't know what will happen. And what actually takes place determines what happens to your portfolio in the next few months.

In the event of a chemical attack on Israel, it is highly likely that petroleum prices would surge as Middle Eastern oil fields are damaged or made inaccessible during the conflict. Loss of life and human suffering would require tremendous US and global humanitarian outlays, and military spending would inevitably climb.

Gold, which is already at fear-driven highs, would spike higher. The dollar, relative to other currencies, would probably decline. Global stock markets would plunge, with the exception of defense, resource, and health care issues. Long-term corporate bonds, especially junk bonds, would decline, as bankruptcies caused by renewed recession became a genuine concern. Such a conflict would not be good news for your stock portfolio in the short term.

If you perceive that such disaster is likely, you might want to reduce your mainstream stock market holdings temporarily. We are already invested in some alternative venues which will do well in the event of a drawn-out war. These investments include a foreign currency component via Harbor International, Swiss Helvetia, and the SoGen Funds. SoGen also owns some gold-mining stocks. In expectation of further economic hardship, consider buying short-term bond funds that invest only in US Treasury notes with maturities of 3 years or less. However, before acting, please review a bit of history.

The last time we crossed swords with Saddam, the stock markets declined, oil prices rose, and doom was on everyone's mind. Many investors sold their stocks and prepared for the worst. Then, of course, the Iraqi military folded like a wet paper bag, the stock markets rocketed up, and these investors wound up being left behind.

A similar market reaction is possible in the event of an allied walkover, or a Saddam Hussein abdication. In the event of the Iraqi dictator decamping to a location where it is not likely to rain cruise missiles, the price of oil could drop within days. The US stock markets could rise very quickly, possibly as much as 10% or more in a week. Gold could plummet like a brick in a well. The dollar could possibly rise against other currencies. It would be reasonable to expect the beginning of a general economic recovery.

Your short-term investment strategy depends profoundly upon which scenario you expect! We're in a unique situation here, because your choices are almost in opposition to each other. If you guess incorrectly, you could hurt yourself financially. Events may easily take place so rapidly that there may be little or no opportunity to change your portfolio's allocation in the midst of the crisis. If your portfolio is already low-risk, it may be appropriate to make no changes at all.

Much more important to your long-term financial success is the shape of the world after the 2<sup>nd</sup> Gulf War is over. Barring any monumental catastrophes, which are possible but unlikely, I believe the future looks bright.

From my perspective, investors are panicking with the same lemming enthusiasm they showed during the tech bubble. Investors are selling out their stocks and stock mutual funds, a phenomenon that we see in history as traditionally and consistently as we see Christmas on the calendar. These investor blowouts have always marked long term market lows.

It is quite possible that stock prices are artificially suppressed due to war fears. Actually, there is abundant positive news, which is being ignored by a media intent on feeding the public what it wants.

One bright but largely unseen beacon is the president's new tax reduction plan. We don't know how much of the plan is reality until it passes through the Congressional digestive system, but the fact that we have a fairly inspired group of economists in charge is heartening. Another attractive feature is that interest rates remain at historic lows. Money—the lifeblood of business— is too cheap for new business creators to ignore.

Yet investors persist in believing that things will always be as they are today. They won't.

All of this reminds me of the 1973-1974 stock market decline, which was truly ugly. Interest rates were shooting up due to the Arab Oil Embargo at the same time the stock markets were tumbling. Nixon was stumbling his way out the White House. Vietnam was a recent all-encompassing depressant, and the Union of Soviet Socialist Republics was widely regarded as the next cool thing. Until our own recent tech-wreck came along, they were the worst years after the Great Depression. S&P 500 results looked like this:

Year	1973	1974	1975	1976
S&P 500	-14.77	-26.39	37.16	23.57

While we're walking down memory lane, let's take a look at the beginnings of the greatest bull market in history, in the early 1980's. Remember the Iranian hostage crisis, Reaganomics, and the debacle in Lebanon? Economically, we were paralyzed by inflation, followed by recession. Here I've enclosed the P/E statistic as well so you can see the hidden verity: when we're in a recession and earnings are dismal, and the price/earnings remains high, it may signal intelligent buyers who recognize that vastly improved earnings are just around the corner.

2003 is definitely a year in which important decisions will be made by all of us. I believe that our fate as a nation and our fate as individuals for the next half-century will be determined to some degree by our individual and national behavior now.

Dow Jones Industrial Average Performance 1980-1983				
Year	1980	1981	1982	1983
T-bill rate	12%	15%	11%	9%
Closing P/E	7.9	7.7	114.4	17.4
GDP	-0.30%	2.50%	-2.10%	3.90%
Performance	22%	-4%	27%	26%

Meanwhile, what am I doing with my own money? I'm buying as much stocks and mutual funds as I can possibly afford.