STELLAR CAPITAL MANAGEMENT, LLC

Economic & Market

Commentary

A Year of Mixed Signals

September 30, 1999

At the start of the year, many were feeling quite optimistic about the financial markets. The "Asian Crisis" was behind us; Alan Greenspan had come to the rescue by lowering interest rates three times, and we were ready to charge into the new millennium at full speed. As the year began to unfold, the tone of the marketplace changed. The economic concerns of 1998 were replaced by concerns about inflation and overheating economies. In an effort to cool our domestic economic growth, Alan Greenspan has increased short-term rates twice this summer. Some believe he's just taking back the easing forced upon him last fall, and others believe he sees inflation coming around the corner.

While economists are split over the need for Federal Reserve intervention, it has happened, and the Fed may consider yet another tightening move in October. Considering that OPEC led cut-backs in oil production have caused a stunning increase in oil prices (double in 6 months), and Inflation at the producer level (PPI) and the consumer level (CPI) are near 25 year lows, one has to question the rationale behind another rate increase. Businesses operating in today's environment face competitive markets, where cost increases are difficult to pass onto consumers. To garner the best market valuations for their shareholders, companies must focus on sales and productivity growth, and converting sales growth to earnings growth.

The mixed interpretations of current economic signals have made it more difficult to forecast the future earnings of many companies and harder to predict future inflation rates for the economy. When these estimates become less certain, the valuation of future cash flows is reduced because you are not as sure how much you will receive, or how much you should pay for it today. In periods like these, markets can become unusually fixated on short-term economic and market related events which increase the volatility of the financial markets.

When evaluating 1999, it is important to remember the magnitude of the market's move since last fall, and that the performance of the popular Stock Market averages have masked the performance of stocks in general, which are well below the numbers posted by the DJIA and S&P 500 Indexes. On a technical basis, the markets have faltered, but barring any surprises, the downside in the markets from here should be limited.

The stability and success of the financial markets will be to some extent dependent on how much our leaders learned from the policy mistakes of the early 70's. While always concerned, I am optimistic that the correct policy will be prescribed and we will continue on a steady course. Portfolios remain well balanced and are positioned to benefit from the long-term potential returns available in the financial markets.