STELLAR CAPITAL MANAGEMENT, LLC

Economic & Market Commentary

Dow 10,000

Is that an echo?

The last time I wrote a Commentary with "Dow 10,000" in the title, it was March of 1999 and there was "exuberance" in the hearts and minds of investors; the Dow Jones Industrial Average was climbing and finished the year up by about 25 percent. This year the market again crossed the 10,000 mark for the first time since crossing it on the way down in June of 2002. The S&P 500 finished the year ahead approximately 28 percent in the face of ongoing governance issues at individual companies and investment firms. The bond market gave up a little ground, as the yield on the ten-year Treasury bond rate rose about 3/10 of one percent.

Over the last year and a half, we correctly interpreted the direction of economic policy and could see modest improvement in the underlying indicators, but the news flow took a while to turn positive. Ultimately, the policies put in place over the last 12 to 18 months had the intended effect, as consumption grew to become the largest percentage of the overall economy since the 1930's. With consumers carrying the economy, businesses have been able to heal some of their wounds and are in a better position to contribute to economic growth. In what may be a surprise to many, the economy could have grown between 4 and 4 ½ percent for the past year, well ahead of the 3 percent average for the last two decades. So far, it looks like the policy makers have been taking the right steps. They (the policy makers) will never make everyone happy, but it seems since the second quarter of the year, the financial markers have sung a different (and better) tune, generally embracing good news and shrugging off the bad.

The huge productivity gains seen recently are a result of increased economic activity being spread over a relatively thin workforce. Even with the spurt in economic activity, companies have been cautious about committing more capital and hiring additional people for fear of potential pauses or rapid reversals in demand. While new and continuing jobless claims continue to drop modestly in the weekly surveys, companies are still relying on overtime to meet production demands, and resisting creating full-time positions. Commercial banks have remained cautious in their corporate lending practices, as loans outstanding to corporations have fallen for the last three years. Granted, these data are a lagging indicator, but we would at least like to see the numbers stabilize.

The task going forward will be to unravel some of these short-term fixes and to recreate the ability to use similar policy tools again when required. This unraveling will take skill and finesse to keep consumption at reasonable levels while businesses continue to make progress, and avoid creating longer-term problems for the economy. The next positive steps for the economy will be continued job creation, which will support consumption, more "non-mortgage" commercial bank lending to corporations, which will help businesses contribute to the economy, and an increase the velocity of the money circulating in our economy. Coming into an election year, a pick-up in both these areas would give the recovery and the current administration a lot more staying power.

As the number of uncertainties facing the global marketplace decrease, global stability should increase. Businesses, consumers and investors, forecasting a more certain future, should be more willing to take a longer-term view of their own situations. Large all encompassing swings in stability, business conditions, and the markets make it tougher to look past present issues, and tougher to maintain a long-term outlook. That long-term perspective is what helps businesses carry out capital spending and hiring plans, consumers look to the next 10 years of their income to finance current consumption, and investors look past the next few quarters of revenue and earnings growth.

There will always be a present day "Dr. Evil" to chase around the globe, and when one is reined in, another will emerge and capture the headlines. It looks to me like the good guys are winning, and that's what is important. That said, it is refreshing to put the finishing touches on this commentary at the end of a good year in the economy and the financial markets.

To our clients and friends, best wishes for an enjoyable and safe New Year.

Stephen J. Taddie
Managing Member
January 2004

2200 East Camelback Road, Suite 130 ▪ Phoenix, Arizona ▪ 85016 ▪ 602.778.0307 (ph)▪ 602.277.4572 (fx)