TrendMacrolytics
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MARKET CALLS

It Could Be Worse... But That Doesn't Mean It'll Get Better

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Donald Luskin

We're heading into the home stretch of what has been one of the worst years -- and one of the most amazing years -- in stock market history. This will be one to remember. And one to forget.

And at this precise moment we are, in many ways, at an important cusp. The markets have recovered from the September 11 shock back up to their pre-attack levels, and pre-attack trends. *But those levels and those trends were recessionary --* and however thrilling the bull move off the September 21 bottom has been, we're still living in a recessionary context.

Just look at these charts. Until further notice, the bear market is alive and well.

NASDAQ Composite

Through Friday, November 30, 2001

S&P 500

Through Friday, November 30, 2001

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Yes, the stock market has made a great move. From the closing lows on September 21 to the closing highs on November 26, the NASDAQ gained 36.4%, and the S&P 500 gained 19.8%. But that, in and of itself, isn't proof of anything. Off the April 4 lows earlier this year the S&P gained 19.0%, and the NASDAQ gained 41.2%. And that ended in tears, as you will no doubt recall.

And yes, it's true that stocks have changed hands -- at the margin -- from frightened holders with losses on their books to brave holders with gains on their books. That gives market psychology lots of resilience in the face of scary news like **Enron's** collapse.

And yes, it's true that the price of oil has come down dramatically, and that is surely a very good thing for the world's major economies. But other than that, it's difficult to find evidence of any substantially improved attribute of the economic world.

What passes as improvement nowadays is when companies reaffirm that they are probably going to make their quarters, as **Intel** did last week. But with the average technology stock trading at a price/earnings ratio of 68 on 2001 earnings, and of 45 based on 2002 estimates (both according to **Morgan Stanley**), we're precisely back to the same valuation levels we saw at the top of the market in March, 2000. These companies had better start dealing out some upside surprises, and big ones at that. This "our business is beginning to stabilize" act just isn't going to support those valuations. And at the same time as an Intel says that they're going to make their quarter, there will be a **Ford** to say that *they* won't.

The day after the terrorist attacks I wrote that "...Tuesday's horrors could be the catalyst the economy and the markets have been looking for. Forgive me if this seems mercenary in light of Tuesday's loss of lives -- but this could be a major buying opportunity" (see "In Crisis, Opportunity" September 12, 2001). This has proven to be right so far, and my only regret is that I've underestimated the speed and strength of recovery. Having forecast this rally, I'm in the embarrassing position of having nonetheless sold it all the way up.

But that's the past. For the last month of this year, the best guess is that we're going to have to see the economy begin to actually grow into the generous valuations that are implicit now in stocks. As ironic as it may seem for all that we have suffered, here we are again -- priced for perfection. And I really doubt that perfection is what we're going to get. TM