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The Ghosts of 2000

Thursday, July 15, 2004
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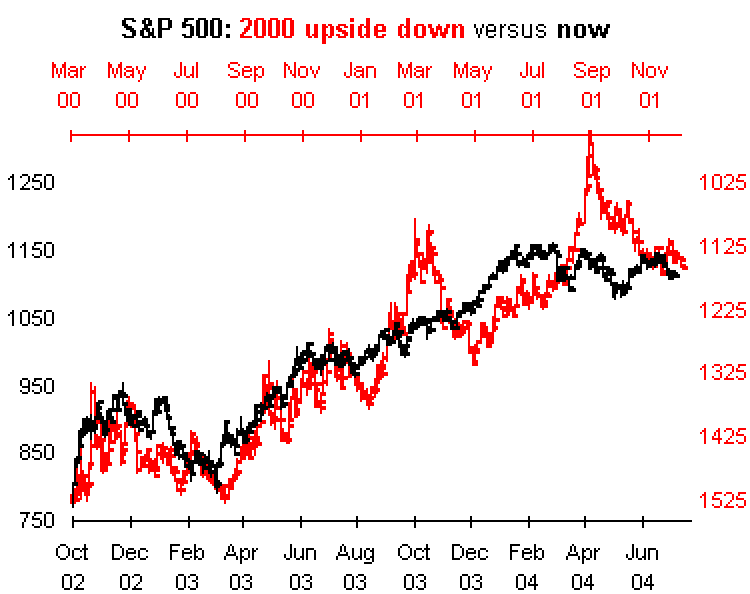
Intel's earnings report evokes the precipice before the fall -- but that was then and this is now.

With the benefit of a full day to think through the market's reaction yesterday to **Intel's** earnings report, it seems that the most concerning element in terms of macroeconomic forecasting was the company's unexpected inventory increase. Yes, the company was at pains to say that global demand for their products has not lessened, portraying the inventory increase as essentially an unintended by-product of better than expected yields. But following on several weeks of poorer than expected economic indicators, it's easy to fall prey to memories of the fourth quarter of 2000, when it suddenly became obvious that demand across the whole economy had fallen over an unseen cliff. In Intel's conference call you could almost hear the ghosts of 2000 wailing: *inventory liquidation... excess capacity!*

There is only one dimension in which an unsettling analogy between today and the fourth quarter of 2000 could be drawn. Much of the fourth quarter of 2000 was spent in the throes of the **Florida** presidential election recount. With **Bush** and **Kerry** locked at 50/50 and still three and a half months of accelerating bitterness and negativity until the election, we face a version of the same thing -- and Bush's pro-growth tax cuts are at stake (see "The Republic of Hanging Chad" July 7, 2004). Uncertainty about that is surely a penalty on equity valuations today, and must be at least a headwind to growth.



But other than that, today could hardly be more different than 2000. If anything, the market today continues to act like 2000 upside-down. We first proposed that idea in October 2002, a week before what would prove to be the bottom of the bear market, when **Pimco's Bill Gross** had just called for "Dow 5000" (see "Q1 2000 Upside-Down?" October 2, 2002). We revisited the idea again in March 2003, days before the secondary bottom (see "NASDAQ 5000, Dow 5000" March 10, 2003). At that time we developed a chart that overlaid the S&P 500 from the October 2002 bottom on the S&P 500 from the March 2000 top, but upside down. Continuing that chart through the present (still scaled only to match the October

2002 and March 2003 bottoms) we find that the present bull market continues to closely conform -- in reverse, and with a little less volatility -- to the patterns of the last bear market. The bull market is running right on schedule, thank you.

Yes, in an important sense this chart is nothing more than a technical curiosum. But it does reflect underlying realities that go some length to quieting the disturbing memories triggered by Intel's inventory challenges. Most notable, in December 2000 **the Fed** was at the end of a tightening cycle that had triggered a deflationary liquidity shortage, and today the Fed is at the end of an easing cycle that has triggered an inflationary liquidity excess. And today, according to our valuation model, equities are precisely as *under*valued as they were *over*valued in December 2000. In fact the Technology Sector today is as undervalued as its been at any time since the October 2002 bottom, and is undervalued even relative to the standards of the conservative pre-1996 era.

The other stark difference between then and now is that now we have memories of then -- and those memories constitute a nostalgic benchmark of glory days that seems impossible to equal (at least that's how those memories are being evoked by **John Kerry's** economic team, who have been telling Wall Street that their plan is to do everything exactly the way **Bill Clinton** did). Yes, corporate earnings are at all-time highs. Yes, more Americans are employed today than ever before. Yes, more Americans own a home today than ever before. But the NASDAQ isn't at 5,000.

In a ***New York Times*** column two weeks ago following the release of the disappointing June payroll jobs number, **Democratic** advocate **Paul Krugman** declared the "Bush boom" to be over, and cited negative data such as: "In the first quarter of 2004, [real GDP] growth was down to 3.9 percent, only slightly above the Clinton-era average." To quibble, 3.9 percent is more than "slightly" above the Clinton-era average of 3.2 percent. But more to the point: 3.9% real GDP growth it is hardly evidence of the end of the expansion. It's a great number -- a number consistent with growth plateauing into the mode of a durable expansion, not just a recovery (see "No Bail-Out for Bonds" July 13, 2004). But again, it just isn't NASDAQ 5000.

Returning to Intel, let's recall what happened *there* in 2000. The company posted record revenues of $33.7 billion, with basic earnings per share of $1.57. This year Intel is on track to set a new revenue record, but earnings per share are forecasted to be only $1.22. Perhaps it wasn't entirely wise of **CFO Andy Bryant** to have said in the conference call that "We're in this business to increase the overall profit dollars, not the percent." When the NASDAQ was at 5000, those goals were not seen as incompatible trade-offs. Today they are and, as should have been obvious all along, Intel stands revealed for the mature monopoly it was even in 2000.

Intel may be a poster-child for nostalgia for the days when hypergrowth hid a multitude of mediocrities. And we continue to think that electoral and monetary policy uncertainties will weigh on equities heavily this summer, probably sending stocks lower in the year's trading range. But there's nothing in Intel's report to suggest the economy is stepping off a cliff. TM