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What's wrong on Wall Street?

Markets are in a slump, and experts don't know when it might end.

By Shonda Novak
AMERICAN-STATESMAN STAFF
Saturday, June 8, 2002

A ccounting scandals. Poor corporate profits. Pessimism about the economy. Spooked investors. All have battered the stock markets in what is emerging as a summer of discontent on Wall Street.

On Friday, the markets ended one of the worst weeks since last fall. The Dow Jones industrial average slumps at a four-month low, down 4.3 percent for the year. The Nasdaq composite index is down 21.3 percent this year, and at its lowest level since October.

The business-page headlines have been a steady stream of bad news.

Concerns are spreading about whether energy companies faked trades to artificially pump up revenues. Federal authorities have a growing list of companies under suspicion for questionable accounting practices. Companies are staggering under huge debt.

But views are mixed about how dire the outlook is for the stock markets.

Some money managers say the markets could start recovering late this year. Others say the economy and the markets face serious long-term problems.

"Until we see the U.S. economy improving and corporate earnings improving, the stock market is going to have a hard time improving," said Mark MacQueen, executive vice president of Sage Advisory Services Inc. The Austin firm manages $2 billion, primarily for institutional investors. "We don't want to hear about any more Enrons or any trickery at the corporate management level or about the way they're dressing up their balance sheets. We'd prefer not to see too much more accounting fraud, although there'll probably be more discoveries about that."

But MacQueen also finds reason for optimism.

"When everyone gets bearish, that's about the time the

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market bottoms out -- everyone who's gotten sick of it has gotten out," he said. "So when sentiment is down, you may be forming the base for the rally."

MacQueen looks for a market improvement toward the end of the year, barring another terrorist attack or similar cataclysm.

Another Austin money manager, Lacy Hunt, thinks the troubles facing the stock markets and the economy are far more grim.

"I'm saying it's related to serious, fundamental long-term problems," said Hunt, executive vice president and chief economist of Hoisington Investment Management Co., which manages $3.3 billion for institutional investors.

Hunt thinks stocks are highly overvalued, and that investors who are bullish about the market and the economy are in for some hard lessons. He's nervous about unreasonably high price-earning ratios -- a stock's price divided by the company's profits per share. The ratio is a broadly used measure of whether a stock is overpriced or a possible bargain.

"Normally, when you've come through a recession, the price-earnings ratio on the Standard & Poor 500 is around 10," he said. The historical average is 15. "And today the ratio is around 35. It's in uncharted territory. . . . The fundamental analysis here does not paint a very healthy picture."

Hunt also is concerned that already weak economic growth could become more feeble still, slowing from about 3.5 percent now to an anemic 2 percent or lower rate by the end of the year. One cause for concern: the nation is gaining low-wage service jobs and losing better-paying jobs in management, manufacturing and engineering. That means less money for consumers to spend and keep the economy pumping.

Because of these and other underlying problems, the stock market isn't playing the role it should in an economic recovery, he said.

"The stock market needs to be rising vibrantly, creating increased wealth, and it's not doing that," Hunt said. "Instead, we're seeing a loss of wealth in the stock market."

Austin money manager Brian Bares said it might be a good time to look for bargains. But Bares, president of Bares Capital Management Inc., cautions investors to be "extremely selective" about buying stocks in most S&P companies because of inflated values and low dividends.

He said the battered telecommunications sector is one place where some bargains might be found. While many of the large companies are in tough shape, Bares said investors should look for smaller telecom companies that have been "unjustly punished -- babies that are getting thrown out with the bath water."

Since the Depression, the historical return on stocks is 11 percent, Bares said. But investors have seen much higher returns during the past 20 years -- sometimes in the high teens. Younger investors who have become used to such returns need to realize that it's not going to continue. Bares said investors should lower their expectations for the next 20 years.

MacQueen agrees. "Investors should be happy with 6 to 10 percent returns over the long run. Forget hitting a home run every day in your portfolio."

There weren't many home-run opportunities for investors this week. The Dow Industrials fell 335.58 points, to 9589.67. The Nasdaq lost 80.25 points, to 1,535.48.

Tyco International Ltd. shares lost 54 percent of their value, closing at $10.10, amid mounting concerns about the company's accounting practices. Chief executive Richard Kozlowski resigned on Monday; the next day, he was indicted on charges he evaded sales taxes on millions of dollars worth of art.

Tech stocks are stuck in a slump, and Intel Corp. didn't help Thursday when it said sales would miss already low targets. Intel is the biggest chipmaker in the world, and it is a bellwether for the tech industry. On Friday, Intel shares dropped $5, to $22 a share.

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