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<u>Dr John Rutledge (Rutledge Research) put it this way</u>:

" These are times when you know that God must have a great sense of humor. The Economy is recovering strongly. Productivity growth is screaming, unit labor costs are falling, inflation is under control and the FED is not raising interest rates from their lowest levels since Elvis was in the army.

Profits, after a 40% twelve month drop, are primed for a sharp increase. And yet investors are selling stock to move their money to places with lower economic growth, higher tax rates, and more opaque accounting standards. They are making a big mistake.

The panic has been caused by a sudden a nd dramatic loss of investor confidence in the US economy, in the prospects for US companies, and in the integrity of our financial statements. Enron, Arthur Anderson, Tyco, Global Crossing, and now WorldCom have shaken investors faith in public company financial statements. Current prices imply that investors have added a liar's risk premium of just over 100 basis points to required equity returns.

Global investors today are rebalancing portfoliod from the US to Europe and Japan, from equities to fixed income, and from venture capital to real estate and hedge funds.

We believe that the cost of capital premium for equities will be temporary. Cash returns on other assets are unimpressive. Accounting standards in other countries ar, in general,less transparent and more subject to manipulation by managers than in the US..."

I COULDNT SAY IT BETTER MYSELF!!!

Don Hays (Previously with First Union as market strategist now running Hays Market Advisory) points out that for the very first time in the last 27 months, the NASDAQ's internal statistics have dramatically outperformed the NYSE's. *<u>That is the way bottoms are formed</u>*

He also points out that nominal money supply is at an all time high...The fuel reservoir is full and running over. In every case that the bearish sentimentover a 3-week period has been this high, the market was at a major bottom.

And, of course, he observes that the S&P 500 valuation composite is now at its most undervalued condition of any time in the last 22 years!!

Don observes (from a perspective of a 30 year market analysis) that Large Cap stocks should show the greatest strength off the bottom and while value stocks have done quite well Bull markets will lead with growth.

Dr rutledge again: " It will take a significant increase in reported profits to convince investors to come out of their caves. That should happen over the next two quarters.."

<u>Let put this in perspective:</u>

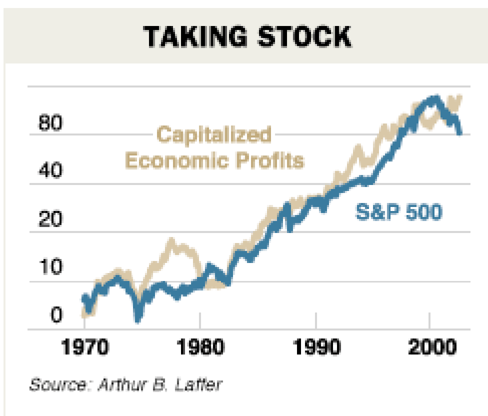
We are probably looking at a very sharp rally later in the year:

The S&P 500 is tracing out an almost perfect pattern, and is hitting the bottom of this range as I write this. From here, we could see a brief bounce, setting up a retest of lower levels into the Fall (Aug 14th CEO reporting deadline looms, and the end of Summer has traditionally been awful).

The channel is clear. A bounce off 830 should occur today. The markets are going to get every last bullish holdout to capitulate

NOTE: The markets have had a large rally that starts from a bottom sometime in the second year of a Presidential term, to a peak sometime in the 3rd year. This has happened during every presidential term since 1914 and the average move up was 50%!!

How Undervalued are stocks?



Whether you take Don Hays 28.7% number or Dr Rutledge's 18% undervaluation or you agree with the 50% undervaluation that appeared in the Wall Street Journal Online Edition last Monday... The markets are irrationally ehuberantly undervalued.

The 50% number ca,me from Dr Arthur Laffer. These valuations are NOT based on what DR Laffer calls "Flim-flam accounting" coming out of companies. He bases his calculation on data from tables of National Income and Product Accounts from the Bureau of Economic Analysis at the Deptartment of Commerce. This is data compiled and normalized from corporate tax returns as filed with the IRS. He takes these corporate profits, and divides by the 10 yr Treasury Note to get his "capitilized economic profits" This give him what the value of USA Inc should be going back decades. (Get a look at the Journal article its worth the read).

Dr Laffer then has two time series to compare. He measures the difference and derives the conclusion that the S&P 500 is 50% below where Capitilized Economic Profits indicate it should be.

The S&P no longer puts any credence in estimate of Operating Earnings, but rather discounts estimates of Reported Earnings. So what is it really worth?

My guess is that the range of value lies somewhere between 869 and 1181 at present.
The S&P is today at 825 approximately. I get this by plugging in estimates of earnings into the FED model. The higher number uses forward estimates of earnings and the lower number uses Reported earnings.

So, my conclusion is that the great beauty contest that is The Market has its judges disagreeing with me (as usual) but its value is pretty close to my lower estimate. The point is that the the potential for up movement is much greater. The market always overreacts. There is a rally coming...perhaps as much as 40% up from here. Hang in there!!

Dave Charlaff