



STAARSM Strategies Report

Note: The STAAR Strategies Report is mailed to all shareholders. It is published on the Web Site at least one to two weeks *after* being sent to shareholders.

Market Comments

8/4/99

Markets Retreat: Correction in Process?

Since their highs, U.S. Stocks have retreated. Most significant is the NASDAQ, which is down almost 10%. Market-watchers have traditionally considered a 10% drop a correction.

The S&P 500 is down almost 7%, but the DOW is only down 4.75%, buoyed by strong performance of a couple of its blue chip stocks. The Russell 2000 Index of Small-Cap stocks is down over 6%.

Internet-related stocks have led the decline. The Dow 40 Internet Index is down 40% since its April 13 peak.

Interest Rate Worries Are A Key

A certain amount of the market downturns should be attributed to normal market fluctuations and the fact that Internet Stocks had been bid up beyond reasonable values. But the prospect of higher interest rates continues to discourage many investors.

The long-term treasury rate has climbed back over 6.1% as the bond market anticipates the possibility of another .25% Federal Reserve rate hike toward the end of August. As long as interest rates threaten to go higher, bond markets will be stalled and stock markets will have a harder time producing gains.

A Repeat of Last Summer's 20% Correction?

Such a steep drop would probably need a trigger greater than another small hike in interest rates. It took an international monetary crisis last year. It would probably take something similar for such a correction to occur now.

However, as the year draws closer to the Y2K reckoning, psychology could be a bit more fragile. For now, a 5%-10% drop looks like a short-term buying opportunity, and internet stocks looking interesting again. A signal from Alan Greenspan that the Fed will not raise rates again would be a positive stimulus. Another .25% increase should not be enough to crash the market. It would need to be something more.

International Stocks Counter With Up Trend

At least short-term, International markets are running counter to the U.S., having risen over the last week. It is hard to say whether the markets will continue to diverge, but history records many times when U.S. and international markets go in opposite directions. This is one of the arguments for International diversification.