



***DOWN  
JONES***

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## **Market Comments-2000**

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### **First Losing Year Since 1990 Sobers Investors**

If 1999 was a year not to be conservative, 2000 was a year not to be aggressive. I have always taught that the universe seeks equilibrium. It tends to abhor excesses.

In my Letter to Shareholders included in the STAAR Investment Trust Annual Report published 2/28/2001 I stated that "sooner or later fundamentals will come into play and companies must eventually demonstrate the ability to make money to justify their prices." Well it was sooner and not later.

#### **.Com Bubble Bursts**

Greed begets foolishness, or is it the other way around? Either way, they are bedfellows.

Like an unorganized ponzi scheme the fanatical frenzy of buying, especially in Internet companies, rewarded early-birds but crushed those who got in later. All of a sudden, investors seemed to realize that the hope of so many speculative start-ups actually making money was slim. Moreover, even if they were to survive, few would make enough to justify the ridiculous prices these stocks were commanding.

Discipline was needed and the market is an unfeeling judge. Greed had many people believing they would be rich overnight. Instead they lost their shirts. Companies that returned three digit percentage gains in 1999 lost 80%, 90% and even 100% in 2000.

## Reality Brought Back Value Stocks

By the end of the year, investors were looking for companies that had track records of profits or valuations that made future profit projections worth considering. Growth was out and Value in.

## Rapid Growth and Inflation Worries Caused Fed to Raise Interest Rates and Hasten the Reckoning

For the last couple years Alan Greenspan had been worrying about excesses, rapid growth and "irrational exuberance". To slow things down the Federal Reserve Board increased interest rates. Now the question is whether the economy will slow too much.

## In Search of Equilibrium

Table A shows 1999 and 2000 results. You will notice that often the biggest losers become the biggest gainers and vice versa. These are the examples we used last year.

The STAAR Funds, which we manage, are included for shareholder reference. (A prospectus may be obtained by calling 412-367-9076.)

The best 1999 categories are at the top. Number one in 1999 was last this year and the bottom performer of 1999 is the top one this year.

**Table A: 1999 & 2000 Benchmark Performance\***

	<b>1999</b>	<b>2000</b>
NASDAQ*	+85.5%	-39.3%
Lipper Emerging Markets Funds	+69.0%	-30.9%
<b>STAAR International Fund</b>	+38.7%	-16.8%
<b>STAAR AltCat Fund</b>	+30.7%	+5.5%
<b>STAAR Smaller Company Fund</b>	+30.4%	+1.1%
Lipper Growth Funds	+28.0%	-10.9%
EAFE International Index*	+25.27	-15.2%
Dow Jones Industrials*	+25.2%	-6.2%

S&P 500 Stock Index*	+19.7%	-10.1%
Russell 2000 Small Co. Index	+19.6%	-4.2%
<b>STAAR Larger Co. Stock Fund</b>	+11.9%	-2.7%
Lipper Growth & Income Funds	+11.9%	+0.4%
New York Stock Exch Composite*	+9.2%	+1.0%
Lipper Balanced Funds	+9.0%	+2.4%
Money Market Funds	+4.5- 5%	+5.5- 6%
Inflation	+2.6%	+3.4%
Gold (price)	+0.2%	-5.7%
<b>STAAR Intermediate Bd Fund</b>	-0.1%	+9.1%
Lipper Intermed Inv Grd Bd Fds	-1.0%	+10.6%
<b>STAAR Long Term Bd Fund</b>	-4.8%	+9.4%
Lehman Bros. Long T-Bond Index	-8.8%	+20.1%
Dow Jones Utility Avg.	-9.1%	+45.5%

\*Preliminary numbers. Some indexes may not include dividend reinvestment.

Investments in stocks, bonds and mutual funds involve varied risks. Past performance is no guarantee of future results. Investment returns and principal values fluctuate so that an investor's shares, when sold, may be worth more or less than the original cost.

## **PERSPECTIVE:**

### ***What Stocks Have Done After Losing Years***

The following table shows each year that large stocks (S&P 500) have lost money and what happened the following year. Losing years that were followed by losing years are shaded.

<b>Losing Year</b>	<b>Return</b>	<b>Following Year Return</b>
1929	-8.4%	-24.9%
1930	-24.9%	-43.3%
1931	-43.3%	-0.82%
1932	-0.82%	+54.0%
1937	-35.0%	+31.1%
1939	-0.4%	-10.0%
1940	-10.0%	-11.6%
1941	-11.6%	+20.3%
1946	-8.1%	+5.7%
1953	-1.0%	+52.6%
1957	-1.1%	+43.4%
1962	-8.7%	+22.8%
1966	-10.1%	+24.0%
1969	-8.5%	+4.0%
1973	-14.7%	-26.5%
1974	-26.5%	+37.2%
1977	-7.2%	+6.6%
1981	-4.9%	+21.4%
1990	-3.2%	+30.1%
2000	-10.1%	?

Since 1926, not including 2000

Average Returns of losing years and following years	-12.0%	+12.4%
Losing Years	20 of 74	27% of years
Profitable Years	54 of 74	73% of years
Number of losing years followed by another losing year	6 of 19	31.6%

Last 50 Years, not including 2000

Average returns of losing years and following years since 1950	-8.6%	+21.6%
Losing Years	10 of 50	20% of years
Profitable Years	40 of 50	80% of years
Number of losing years followed by another losing year since 1950	1 of 10	10%

## OUTLOOK:

### POSITIVES

**Falling Interest Rates and Potential Tax Cuts** – Rates have been falling due to economic slowdown and anticipation of a Federal Reserve rate cut expected in January. Lower interest tends to stimulate the economy and therefore is positive for stocks. A moderate tax cut would also help to stimulate the economy.

**Stockmarket Housecleaning** – The excesses of the past few years, especially in the technology sector, has brought stocks down to more realistic and supportable valuations. There are still some dust bunnies, but overall stocks are more favorably valued.

**History of Stock Market Rises after Losing Years** – As shown in Chart B, the year following a stock market loss is usually a positive one.

**Investor Habits** – Investor education has resulted in investors sticking with dollar-cost-averaging plans and even buying when the market drops. Continued demand for stocks among many investors is a good prescription for limiting losses and setting the stage for the next increase.

**Technological Revolution Still Intact** – The housecleaning was necessary. But it will take more than a correction or even a recession to derail technological growth.

**Global Productivity** – Overall the prospects for expansion are still good. It would take a major depression to derail the direction of the world's economy. A slowdown or a recession will only be a brief interruption of this trend.

## NEGATIVES

**Threat of Recession** – For the first time in a decade, recession is a possibility. If we are headed to one this year, the markets may go down more before they go up.

**Weak Credit Markets** – One of the fuels for the recent speculative stock market was easy lending from many banks. Many of these loans have turned bad and financing is getting harder to find for many businesses. Tight money will have a negative effect on expansion.

**Fickle Investor Psychology** – When either greed or fear dominate, danger is magnified.

## MIXED SIGNALS

**Slowing Economy** – A slowdown is healthy. Of course a recession would be difficult and if it can be avoided, that is best. But a normal recession won't kill the goose.

**Inflation** – There are still some problems in energy and other areas, but nothing that would seem too severe.

**Consumer Confidence** – Confidence has been slipping. Hopefully consumers will not pull back too much. That could help cause recession.

**International Markets Large Decline Leaves Room for Large Recovery** – Do you believe in equilibrium?

## ***Outlook for Allocation Categories***

**Bonds** -- *First Quarter: Favorable, 1-5 Years: Average*

**Larger Company Stocks** -- *First Quarter: Neutral, 1-5 Years: Average*

**Smaller Company Stocks** -- *First Quarter: Neutral, 1-5 Years: Average to Above Average*

**International** -- *First Quarter: Neutral, 1-5 Years: Above Average Returns*

**Alternative Categories/Ten-Year Trends** -- *First Quarter Selectively Favorable, 1-3 Years Above Average Returns compared to S&P500*

NOTES: Neutral 1-3 months means probability of gains or losses is about 50%. "Average" for 1-5 years means returns near the long-term averages of that category, i.e. 10-11% for large stocks, 11-12% for Small stocks, 9-11% for international and 5-7% for bonds.