

THE ROANOKE TIMES

roanoke.com

Sunday, July 10, 2005

Taking stock of market signs

By [Lois Caliri](#)

981-3117

Afraid to look ahead as you travel the investment highway? The market is difficult to predict, but some analysts say things are looking up.

You're traveling along the investment highway, and you're glued to the rearview mirror. Gee whiz, you say, maybe I shouldn't be in the stock market.

After all, investors have just endured 2 1/2 years of negative returns, based on losses from stocks purchased five years earlier. You have to go back to the 1930s to find a longer stretch of negative five-year returns, said David Nelson, senior vice president at Legg Mason Capital Management.

Two signature events contributed to investors' losing money: the pop of the high-tech bubble and the aftermath of the Sept. 11, 2001 terrorist attacks.

Shareholders are still traumatized by the bear market.

But things are looking up, Nelson said.

He recently urged about 100 investors in the Roanoke Valley to look through the front windshield.

"It's the better view," Nelson said. He said he wished people would suffer five-year amnesia.

"People should be more optimistic."

Why?

"Businesses have record free-cash-flow margins; companies are making lots of money and they have huge cash positions," Nelson said. They're going out and buying other companies. Recently, the deals have been reasonable and stocks have been responding favorably to the prices of mergers.

Of course, not everyone agrees.

No one can predict what the market will do, said Vijay Singal, professor of finance at Virginia Tech's Pamplin College of Business.

When a company announces it is increasing capital expenses, that's a healthy signal the company will do well, and its stock prices go up, Singal said. But brokers and financial planners do not have private information about the company, so there's no basis for them to say whether the company will earn more than its normal return, Singal said.

"We cannot say what the market will do for the remainder of the year because if we could say that, why would anybody invest their money now," he said.

Over the long term, five to 15 years, investors can expect a return that, when adjusted for risk, is a fair return, he said.

Small stocks generally yield a higher return because they're riskier, Singal said. When you invest in a risky company, the risk is the uncertainty of how the company will perform - unlike investing in Wal-Mart where there is relatively less risk.

The academic perspective does not stop investment professionals and business leaders, however, from speculating about the market's performance.

"Companies are behaving cautiously, spending half of the cash flow, just above depreciation," Nelson said. Capital expenses as a percent of cash flow are at the lowest levels since 1973.

Also, large corporations are buying back stock at record levels. Some 380 companies in the Standard & Poor's 500 index bought back \$82 billion of their own stock in the first three months of the year, a 91 percent increase from a year before, according to Business Week. Dividends from the S&P 500 companies rose 16 percent, to \$49 billion, in the first quarter compared with a year earlier.

When companies buy back stocks, fewer shares are available to the public, which, in turn, tends to raise the value of the stock. Investors figure if the company buys back its own stock, then it is a good buy. Demand could outstrip supply and stock prices tend to rise, Nelson said.

Having said all that, Nelson said the market will thrive for the rest of the year. Stocks have already started rebounding from the year-to-date lows struck in April.

"But remember, some sectors may thrive when others may dive, so it really depends on which sectors and which companies you are invested in," Terry VandeLinde, president of VIP Planners in Roanoke, said in an e-mail.

"If you own only one stock in only one company, you might get lucky and win big time, or you could lose a much greater amount than if you had other investments to balance your losses," VandeLinde said.

He expects occasional periods of gains and losses for the remainder of the year. He does not expect the large gains of the '90s, but neither does he expect the large losses of the early 2000s.

"Despite short-term uncertainty, we remain confident in the long-term potential of the stock market as a whole," he said.

The fear factor

A lot of people are afraid of the stock market because they got burned so badly, said Andre Monsour, branch manager of Monsour Asset Management in Roanoke.

Those who invested during the dot-com and telecommunications frenzy in the late '90s bought stock at \$60, \$70 a share. "Some dot-coms traded as high as \$300 a share," Monsour said. "Then Enron came and hurt a lot of people."

But things have gotten a lot better and lot more stable, he said. Higher earnings and growing corporate cash piles are delivering gains.

All that money allows corporations to go out and buy other businesses, pay shareholder dividends or pay down debt, said Churchill Robison, an investment adviser with Raymond James Financial Services in Roanoke.

These boosts are coming to a stock market in which prices are more reasonable today than they were in 2000, Nelson said. The most reckless speculators have moved on to the real estate market.

A lot of investors are watching as the Federal Reserve raises interest rates. When interest rates are high, companies tend to hold back on expansion plans or making new products because their rate of return won't be as high on their investments. Corporate profits also are hurt by increased interest expense. The value of the company's stock falls.

Conversely, when rates are low, companies can increase profits by reducing their interest expenses. The value of the company's stock rises.

The Fed raises rates to head off future inflation. But too much of an increase could precipitate a recession.

An easing, or rate decrease, aims to spur economic growth. But a significant decrease could spur inflation.

"The market is always a proxy vote for how people view where the country's economy is going to be six to nine months down the road," Robison said. All eyes are on oil prices, which recently shot through the \$60 barrier. Even then, the stock market fell only slightly.

But the continued high price of oil is a potential negative for the market, Robison said. "Others are the unknown and unforeseen problems in Iraq or a successful terrorist attack affecting U.S. interests, the continual trade deficit and whether foreigners will continue to finance our current-account deficit.

"Driving the whole process is whether consumers will continue to spend given their existing levels of debt."

On the other hand, he said, the market has continued to benefit from low inflation rates in the United States, low interest rates, and improved corporate efficiencies and technological innovations. Furthermore, the U.S. has been seen as a good place to invest money.

The impact of energy prices

Energy stocks, especially oil, are paying good dividends because of world demand. China, with 1.3 billion people, is creating jobs and building its infrastructure. India is doing the same. They need oil. Yet, "energy certainly is a fair weather stock," said Chad Tilley, president of AmeriReps.

Tilley invests in midcap (companies with capitalizations of more than \$1.5 billion) and small-cap (companies with capitalizations of less than \$1.5 billion) value stocks. Capitalization is calculated by multiplying a company's outstanding shares by its current stock price. For example, a company with 100 million shares outstanding at a current market value of \$25 a share has a capitalization, or cap, of \$2.5 billion.

Recently, the U.S. Senate passed an energy bill designed to help promote development of additional supplies of natural gas. It would also encourage the use of clean-coal technology, in an effort to lessen "wasteful" use of natural gas for generation of electricity, preserving more natural gas for home heating and manufacturing, said John Williamson, president of RGC Resources, parent of Roanoke Gas.

The U.S. House of Representatives has also passed energy legislation that significantly differs from the Senate version.

If the politicians work out a compromise energy bill and President Bush signs it, then, Williamson said, "We should begin to see some price relief and a return to energy price stability."

The repeated failure to adopt comprehensive energy legislation has contributed to record high oil and natural gas prices and created a drag on the economy and stock market, Williamson said.

Energy prices are affecting the market, which translates into a "lot of nasty things," including inflation and the overall stress on the economy, said Bill Clingempeel, portfolio manager at SunTrust Bank in Roanoke.

The high price of oil is dragging down the market. A lot of speculation is going into that market, with investors wondering if oil will come down to its intrinsic value. Also, oil prices are hurting the bottom line in other industries, including airlines and trucking companies.

If interest rates go up and the economy slows down, oil prices will fall, Monsour said.

Some investment professionals, including Clingempeel, say the market is likely to rally at the end of the year just as it did a year ago.

"Last year if you bought stocks Jan. 1 and sold them any time before November you would have lost money," Clingempeel said. Yet the S&P 500 returned more than a 10 percent gain in 2004, including reinvested dividends, because of a rapid run-up in December.

Corporate profits are increasing in the aggregate, which will translate into higher stock prices.

"We expect moderately higher stock prices this year, not like the 1990s, but solid positive returns for 2005," Clingempeel said.

What makes stocks an even better investment, even at moderate appreciative levels, is the 15 percent capital gains tax as well as the 15 percent tax on dividend income, he said. You can pay less tax on your dividends than you would on other income.

Do your homework

But "we should never assume that investments in the stock market grow or fall with any consistency," said VandeLinde of VIP Planners. "Fluctuation is constant, and past

performance is no indication of future results."

He noted that over the past five years, the S&P 500 dropped nearly 6 percent, while real estate prices increased more than 56 percent. Over the past 25 years, home sales prices increased 257 percent. However, over the same period, the S&P 500 rose more than 1,000 percent.

Business Week magazine reported recently that investors can improve their chances by picking a couple of promising stock sectors, such as health care companies and large-cap growth stocks, and avoiding others, such as finance and banking companies and small-cap value stocks.

"For the most part you have to be very diligent in choosing the right stock; doing your homework, making sure it's a sustainable trend," Tilley said.

"Just like when people talk about Warren Buffet. He didn't believe in the telecom industry; he didn't understand it. Now, he's the second richest man in the world because he only did things he believed in and knew about."

(C)2005 The Roanoke Times

[Close](#)[Print Page](#)