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## An Enthusiasm Grounded in Fundamentals

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New market high points inevitably are when many would-be investors begin to fret that everyone is getting rich but them, but the time is already past to make big money in the markets.

With the Dow Jones industrials and other major market indexes flirting with historic highs, is this one of those times?

A variety of investment professionals and strategists don't think so. Each expressed the belief that the U.S. equity market's steady, slow climb back from the 2002-03 trough has been driven by bedrock, fundamental strengths in the economy, not speculation. They also say there's very little reason to believe we are at a peak, with a diverse mix of inexorable demographic and economic forces, both here and abroad, pointing to sustainable underlying business performance.

In short, while short-term profits in the stock market are never assured and are dodgy to predict, the long-term chances of building wealth are pretty good, even if you start investing now.

Yet even in the short term, analysts say there are many good reasons to be optimistic about the stock market and the economic cycle in the next year or two.

Among them, stock prices are much lower compared with corporate earnings than they were during both the bubble of the late 1990s and the depths of the stock market slide in 2002.

"The economy is still rising on a reasonable basis. Corporate profits are still rising," said Harvey Hirschhorn, chief portfolio strategist for [Bank of America Corp.](#) "I'm upbeat at this time. We think we have lots of risks and uncertainties, but the cycle is favorable to equities investors."

Right now, the firms in the Standard and Poor's 500-stock index are trading at about 16.8 times the previous year's operating earnings per share, compared with 28 times at the index's peak in March 2000 and 20 times at the low point in October 2002, said Sam Stovall, chief investment strategist for Standard and Poor's Corp.

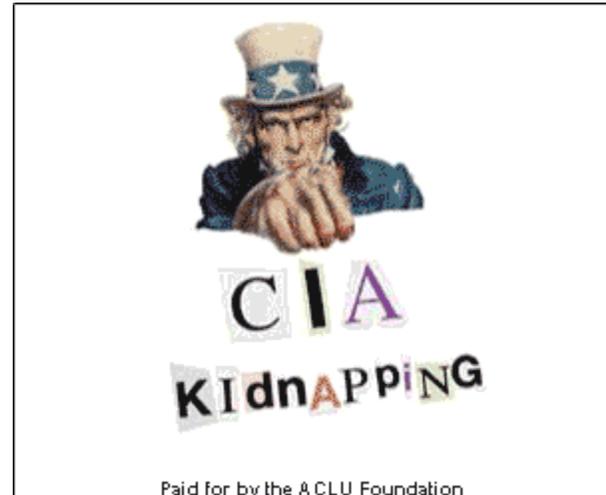
"The market is almost 50 percent less expensive," enthused Jonathan Golub, U.S. equity strategist for [J.P. Morgan Chase & Co.](#) "During the late 1990s, profits were healthy and strong, but [stock] price movement far exceeded earnings. Today, it couldn't be more different."

Also, although the Dow is close to its all-time-high close of 11,722.98, set in January 2000, it is not yet close to an all-time record when inflation is factored in. If increases in the consumer price index are included, the Dow would have to reach close to 14,000 to set a true new high, according to William J.

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Hausman, an economics professor at the College of William and Mary.

Other indexes, such as the S&P 500 and various growth-stock indexes, have risen in recent years but aren't near their all-time highs.

"Value stocks and small-cap stocks have had a great run and have been high relative to large-cap stocks," said Gus Sauter, chief investment officer at the Vanguard Group Inc., a mutual fund company. "Small caps historically trade at a discount to large caps. That discount has been largely wiped out. Large caps haven't had their day in the sun yet, and some people think the time may be now."

This is not to say the market is confused about what makes a good stock. Philip D. Tasho, a longtime value investor who is chief executive of institutional investment management firm Tamro Capital Partners LLC in Alexandria, said there is a variety of reasons why stocks of different sizes and sectors have all had good runs this year. And they're mostly very good reasons.

"Compared to early 2000, it's totally different," he said. "The market is a mirror image of then."

Tasho said company performance has been the biggest driver of investor enthusiasm. Businesses, especially U.S. corporations, continue to make strides in productivity, and a rising global economy has created myriad opportunities both for U.S. multinational corporations and for investors looking for growth opportunities in foreign markets.

"The biggest concern is if we have any excesses, or if this market will produce excesses," Tasho said. "On that score, I would say the biggest worry is housing. But it seems to be softening slowly. The gradualism of the last 15 rate hikes seems to be working."

[Citigroup](#) economist Steven Wieting calculates that corporate operating profits for the S&P 500 companies have risen 94 percent since they bottomed out at the end of 2001, while share prices have risen only 18 percent since then. "A nice piece of this [share price growth] is sustainable," Wieting said. "We haven't had the exuberance that has typically been the undoing of other recoveries."

Wieting said that since the end of World War II, recessions have been getting shallower and recovery and growth periods have lasted longer. "Our last two cycles averaged nine years each," he said. "The economy matures, and, in the case of the United States, it has gotten more diverse. Industries boom and bust simultaneously."

The U.S. gross domestic product -- the output of goods and services -- expanded at a 4.8 percent annualized rate in the first quarter, the highest rate in two years, according to an early estimate by the Bureau of Economic Analysis. Although the Federal Reserve said Wednesday that it expected growth to slow from that torrid pace, many economists are predicting a healthy 3 to 4 percent rate for the rest of 2006.

"We're in the mid-cycle," said Richard B. Hoey, chief economist for the Dreyfus Corp. "Usually the cycle is ended because of a problem like excessive inflation, and we haven't seen that. . . . The economy has continued to expand, and profits have continued to grow." He argues that the three-plus-year run-up in stock prices can mostly be attributed to the market "renormalizing" after a period when corporate scandals and the implosion of the technology bubble had made investors overly pessimistic.

Jeff Seely, chief executive of Sharebuilder.com, an online investing service, said his customers are definitely bullish.

"Is the market ahead of itself? I think not," he said. "The current rally has a reassuring tone to it for small investors. In recent weeks, we've seen our transaction volumes running substantially above what we thought they would for May. The weather got warm, but the market didn't cool."

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