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# THE VIEWPOINT

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## IS THE GLASS HALF FULL OR HALF EMPTY?

When looking at the economy and the stock market, it is easy to get caught up in the bad news of the day and forget to step back and look at the entire picture. People tend to look at the glass and see it half empty instead of half full or more.

For example, the news is full of headlines about record oil prices, the cost of the war in Iraq, hurricanes Rita and Katrina, problems with airline carriers, U.S. auto manufacturers' difficulties and many other setbacks that we have experienced this year. The economy must be in trouble. The economic glass looks half empty.

When you step back and look at economic indicators you see a different picture. During the last 30 years there have been only 2 periods when unemployment has been lower than it is today. Productivity is at an all time high. Inflation is in check, even with the wild swing in oil prices. The economy (Gross Domestic Product) is growing at a rate of 4.1%. The Government is experiencing a record collection of income taxes even with a lower rate structure. The economic glass looks half full.

The stock market is similar. The Dow Jones Industrial Average was down .60% during 2005. If you go back 5 years, which includes the technology sector blow up, 9/11 and a recession, the Dow Jones Industrial Average is

slightly positive. You would have made more in a money market fund. The stock market glass looks half empty.

Step back and look at the past 3 years and you will find that returns have been much better than money markets. For example, the Dow Jones Industrial Average is up more than 8% a year over the last 3 years. Over a 10 year period the Dow Jones Industrial Average is up almost 8% per year and if you go back 20 years you find an annual return of over 10%. The stock market glass looks half full.

The average U.S. company is projected to grow its earnings at 9% next year and is trading for 17 times earnings. If earnings come in as expected and P/E multiples stay the same, you would expect the market to go up 9%.

So, the question remains: are the economic and stock market glasses half full or half empty? With the economy growing in spite of all the setbacks we have endured and with earnings projected to continue to grow, I would say the glass is more than half full. This would lead you to expect the economy to continue to grow and the stock market to go up along with earnings.

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### Bond Yields and Returns

With the Federal Reserve raising short term rates, most assume all rates are going up. As the graph on the right shows, it is only short-term bonds that have seen their yield go up. When rates rise, bonds fall in value.

Long-term bonds and long-term oriented bond funds have held their value while short-term bonds (5 years or less) and short-term oriented bond funds have seen their value fall. The good news about owning individual bonds rather than bond funds is that when they mature you will recover the paper loss.

We own short-term, individual bonds in our balanced accounts. Due to the rise in short-term rates, bonds have subdued the performance in those accounts. As these bonds mature we will be able to take advantage of the higher interest rates that are available when we reinvest.

Treasury Yield Curves 12/30/05

