To: Our Clients
From: Victor Levinson and Nicholas Levinson July 22, 2002

Re: Special Mid-Month Comments on Stock Market Declines

The following are segments that were to appear in our August 2002 Comments. Given the dramatic declines in all the broad stock market indexes over the past two weeks of July, we wanted to provide you with information that we believe is highly useful in putting the current Bear Market of 2000-2002 in a context with the two other major Bear Markets since 1926. We think the history of past stock market declines and recoveries provides at least some guide as to what the future may hold.

The figures below show the declining and then recovering value of a $1 million stock portfolio, based on an index of Large Cap US stocks (most recently the S&P 500), as reported in Ibbotson Associate's 2002 Year Book: Stocks, Bonds, Bills and Inflation.

Year	% Losses or Gains	Portfolio Value
1929	-8.42%	915,800
1930	-24.90%	687,800
1931	-43.34%	389,700
1932	-8.19%	357,800
1933	53.99%	550,900
1934	-1.44%	540,300
1935	47.67%	801,800
1936	33.92%	**1,073,800**
1937	-35.03%	697,700
1938	31.12%	914,800
1939	-0.41%	911,000
1940	-9.78%	821,900
1941	-11.59%	726,700
1942	20.34%	874,500
1943	25.90%	**1,101,000**
1944	19.75%	1,318,400
1945	36.44%	1,800,000

Year	% Losses or Gains	Portfolio Value
1973	-14.66%	853,400
1974	-26.47%	627,500
1975	37.20%	860,900
1976	23.84%	**1,066,200**
1977	-7.18%	989,600
1978	6.56%	1,054,500
1979	18.44%	1,250,000
1980	32.42%	1,654,000

Year	% Losses or Gains	Portfolio Value
2000	-9.10%	909,000
2001	-11.90%	800,800
2002 (thru 7/19)	-26.10%	591,800
2002 (post 7/19)	???	???

While these figures focus on the most serious down markets and their recoveries, it is important to remember that since 1926, Large Cap US stocks have had an average annual positive return of 10.7%, compared to 5.34% for bonds (5-year US Treasuries). This means that an investment in stocks would have doubled every seven years during this 76-year period, while a comparable investment in bonds would have doubled every 14 years (not accounting for the impact of taxation or inflation). This is the very basic reason why people invest in stocks, even with the potential for prolonged periods of decline.

Turning to the figures and their underlying circumstances, the 1929 to 1945 period was clearly the worst for average annual stock returns. The year 1929 and the early 1930s involved a stock market crash and a worldwide economic depression that, at its depth in the US, saw unemployment reach 25% and gross national product decline by 25%. The 1939-1941 period covered the years immediately preceding US entry into World War II. Four years of stock market declines (1929-1932) caused a cumulative loss of 65%, during which time the $1 million portfolio would have been reduced to $357,800. The losses were fully recovered, with a slight gain, over the following four years (1933-1936). There followed another six-year period (1937-1942) during which the portfolio value would have been lower than the initial $1 million investment, until 1943, when the portfolio value finally would have decisively exceeded the original $ 1 million. (Note that the 1939-1941 period, which involved three consecutive years of declines, amounted to a cumulative decline of less than 25%, which was nowhere near as serious as that of the 1929-1932 period, or, as we will see in the next paragraph, the 1973-74 period). By 1945, the initial $1 million would have grown to $1.8 million. It therefore took 17 years for stocks to achieve a reasonable dollar gain. The annualized return for the entire 17-year period would have been 3.5%, far below the 10.7% long-term average annual return. Note, however, that the annualized return from the 1932 bottom, when the value fell to $357,800, to the 1945 value of $1.8 million, was 13.2%. Clearly, selling at the bottom would have been a bad idea.

The 1973-74 years were characterized by recession, soaring oil prices and oil shortages, runaway inflation, and double-digit interest rates, as well as the Watergate scandal that ultimately forced then-President Nixon to resign. Amidst all that bad news, stocks declined over 40% in two years. By 1976, two years later, stocks had recovered all their losses. After two inconclusive years (1977-78), stocks made large gains in both 1979 and 1980, so that the entire eight-year period would have generated a gain of $ 654,000 on the original $1 million portfolio value, or an annualized return of 6.5%. Measured from the 1974 lows, over the next six years stocks would have risen in excess of $ 1 million, for an annualized gain of 17.5%. Here again, amidst great gloom and doom, selling at the bottom would have been a costly mistake.

Selling stocks now would mean that the problems affecting today's stock market (which have been presented in detail in our recent regular Monthly Comments) are so great, and so much greater than the problems overcome over time during previous stock market recoveries, that stock prices are not likely to recover this time. (This point assumes that your allocation to stocks was, and continues to be, reasonable for your circumstances.) **Our view is that the current problems are not of such a magnitude as to negate the history of previous declines and subsequent recoveries that occurred during each of the two major Bear Markets since 1926, and that relying on the history of long-term positive stock price movements is a far better strategy than reacting to the shorter-term negative volatility.**

Furthermore, if you sell stocks now, the alternative liquid investment is bonds, which are currently at historically low yields (e.g., the 5-Year US Treasury yield is under 4%). By moving to bonds now, you would end up with a more certain but low return, while giving up the opportunity of achieving a considerably higher return from stocks, particularly as they recover from a period of significant declines. Remember, stocks need only outperform bonds from this time forward for the decision to maintain your stock allocation at this time to be the correct one.

There is also a strategy that involves selling stocks as their prices are declining, and buying them back at lower prices, so as to benefit from the recovery suggested by history. This strategy is referred to as Market Timing, and is generally discredited based on the idea that noone knows **WHEN** the declines will end and the recovery begin. However, if you are convinced the current declines have further to go, and are willing to take the chance that an upturn will not occur before prices move lower, then this is a strategy to consider. If you choose to implement this strategy, however, you will still have to pick a time to buy back stocks at lower prices than the prices at which you sold, and/or be willing to miss out on some of the potential upturn in stock prices. While we do not recommend attempts at Market Timing, we are available to discuss the idea if you are interested in implementing this strategy for portions of your stock portfolio. Furthermore, if this period of negative returns has led you to question your risk tolerance and overall allocation to stocks, we are available to discuss this issue with you as well.

To close these special mid-month Comments, we refer to the July 20th New York Times article by Floyd Norris, commenting on the recent stock market declines that culminated with the sharp drops of Friday, July 19th. "In the nine weeks beginning a week before Memorial Day,…the major US stock market averages have lost more than 20% of their value, one of the fastest falls in Wall Street history….Historically -at least since the end of the Depression- <u>such rapid declines have come near the end of bear markets and have often been followed by rapid advances</u>." The article discusses the fact that the declines have caused some people, mostly retirees, to cut back on their spending. It also discusses the impact of the continuing accounting scandals that began with Enron, and moved on to Worldcom, concluding in part: "Just what caused share prices to plunge is not clear…, but the Worldcom disclosures may have been significant." The article also refers to the bear market that ended in 1974, which "came in the midst of a severe recession that was far worse than the minor downturn that is thought to have ended early this year." The article concludes with examples of comparable nine-week declines in recent history, 1962, 1974, 1987, and 2001 (post-9/11). "In each of the first three cases -1962, 1974 and 1987- there was a solid long-term opportunity to buy stocks." The outcome of the 2001 decline is in question, since "the gains following September 11th have now evaporated."

Our advice continues to be to use the long-term history as a guide, consistent with having an asset allocation to stocks and away from stocks (i.e., to bonds and cash) that is appropriate to your circumstances.