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Vendex Group of Companies SEPTEMBER, 2002

Stock Market Overview

As most of you are well aware, stock markets around the world have been severely battered during the past months. Since their peaks in 2000, the market declines now rival the worst bear markets since the Second World War. In the United States, the Dow Jones has fallen 35 per cent from its high, while the broader Standard & Poor's 500 Index has declined 47 per cent. The tech-heavy NASDAQ Composite Index meanwhile, which led the market advance in the late 1990's, has now collapsed 76 per cent as numerous companies have gone bankrupt and many others are struggling to survive. In Canada, which until recently had held up relatively well, the TSX Index has now fallen approximately 44 per cent from its peak, also in 2000. Actually, Nortel, which at its high constituted over 35 per cent of the Index has now fallen to under two per cent. This decline has accounted for two-thirds of the drop of the TSX.

Ironically, the market declines during the past few months have come at a time of generally accommodative central bank monetary policies, expanding economies, improving corporate profits, as well as low inflation and interest rates. However, there has been a "crisis in confidence" reflecting issues such as the scandals and revelations regarding poor corporate governances and business ethics, the ongoing woes in the tech and telecom sectors and the weakness in the heretofore strong U.S. dollar. This negative sentiment has overwhelmed improving fundamentals resulting in indiscriminate selling of stocks. Even groups such as the gold and resource issues which had held up well, caught the recent down draft. Of note, such indiscriminate selling is normally a sign of the final stages of a decline.

As you know, markets have a tendency to repeat themselves. In this regard, recent studies that suggest that we are near the end of the sell off and that investors will begin to focus on the positives not the negatives. The first relates to the decline in prices since the beginning of the year and their apparent "disconnect" from the economy. While not a normal development, such disconnect has happened in the past, most notably in 1962 and 1987. In both years, the markets came down hard in a short period but then recovered well. In the current case, the market decline both in percentage terms and in time is near the limit seen in those two years.

The second study to note has been the remarkable periodicity of the market since the early 1960's in establishing a major bottom virtually every four years. The last such bear market low occurred because of the Asian crisis in August 1998. Based on this pattern we should be closing in on a major low. Incidentally, a recent study by Merrill Lynch & Co showed that from these four-year lows, the United States stock market advanced on average better than 30 per cent over a one-year time frame and more than 40 per cent in two years

While there is no doubt we underestimated the extent to which investor psychology has weighed on valuations, with the bear market already at historical extremes, both in price and time and with the economic outlook, in our judgment, still favourable, the recovery potential from these levels is excellent.

Conclusions

With the latest sell off, we believe the stock markets are most attractive for investors with patience. We continue to recommend that clients maintain their long-term strategies, emphasizing a balanced approach with above average weighting in equities and real estate. Within client limitations we also remain bullish towards mid and small cap stocks using funds such as our Canadian mid cap and U.S. mid cap portfolios.

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