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Economic Woes Don't Slow Stocks

Wall Street may be predictor of recovery

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Does Wall Street know something that Main Street doesn't about the prospects for a quick economic recovery?

Stock markets have rallied in recent days, wiping away losses sustained after the Sept. 11 terrorism and closing in on milestones established in more prosperous times. The Dow Jones industrial average is poised this week to break through the psychologically important 10,000 mark.

The benchmark indexes have increased in six of the past eight weeks. The blue-chip Dow ended last week up 2.7 percent and the technology-laden Nasdaq composite index gained 3.8 percent. Since their lows on Sept. 21, the Dow has climbed back 20 percent and the Nasdaq, 33 percent.

Yet most experts say the nation is mired in recession brought about in part by the terrorism. The pace of layoffs has accelerated on news of growing consumer pessimism about the future; manufacturing is gripped by the deepest depression since the 1930s, and retailers are bracing themselves for the worst holiday shopping season in 33 years.

"The stock markets forecast what the economy will be doing six to nine months down the road," said Albert Fredman, a finance professor at California State University's Fullerton campus. "What they are saying now is that sometime in 2002, we will have better times . . . People should be encouraged by this stock market rally."

Fredman and others also pointed to a recent slump in bond prices, particularly of 10-year U.S. Treasuries, as another sign that the current recession would be short-lived.

U.S. Treasury prices staged a mild comeback yesterday after a six-day losing streak fueled by fears the Federal Reserve is done lowering interest rates.

The bond market generally slides when investors see an economic rebound on the horizon and anticipate a rise in rates, which in turn makes bonds less attractive compared with stocks.

"There's a seesaw relationship between the stock and bond markets – when one is up, the other is generally down," Fredman said, "And this is a typical case which indicates the U.S. economy will come back."

Wall Street's predictive powers have been the subject of intense debate for generations at stock brokerages, banks and universities, as well as on Capitol Hill. Most experts yesterday described the stock markets as "the leading indicator of the economy's future direction," but each also cited examples of the inaccuracy of investors' crystal balls.

Anthony Chan, chief economist at Banc One Investment Advisors in Columbus, Ohio, said stocks are a better gauge of recovery from recession than bonds. In each of the eight downturns since 1953, stocks more accurately forecast a rebound by rallying than bonds did by falling.

"The bond market is not as successful as the stock market in providing signals of future economic recoveries," he said. "The equity market appears to celebrate the impending economic recovery a lot sooner on average than the bond market begins to worry about the same turnaround . . . and fear potential inflationary pressures" as seen in higher interest rates.

That was the case yesterday with investors interpreting a smaller-than-expected decline in the construction of new homes last month as further proof the country is shrugging off the effects of Sept. 11. The Dow rose 109.47 points, or 1.1 percent, to close at 9976.46. The Nasdaq climbed 35.84, or 1.9 percent, to 1934.42.

"This is a sign of the early phase of a new stock-market cycle," said Subodh Kumar, chief investment strategist at CIBC World Markets. "The market set its low on Sept. 21 after the terrorist attacks, and now we're seeing stocks come back." He predicted the Dow Jones index would rise to 11,500 in the next 18 months and the Nasdaq to 3,300.

Others were more pessimistic.

Ian Morris, chief U.S. economist at HSBC Securities in Manhattan, said stocks are likely to dip again on news of higher unemployment. He forecast the jobless rate would soar to 6.5 to 7 percent by next spring from the current rate of 5.4 percent.

But Morris agreed that the overall trend in the stock market is upward.

Citing the familiar joke among investors and economists that the stock markets have accurately predicted 12 of the last seven recessions, he said: "The markets tend to be right, but not always. This time, however, I suspect they are right in anticipating a recovery."

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