

## Perspectives - On Business

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Great Expectations

***"Statistics: The only science that enables different experts using the same figures to draw different conclusions."***

Evan Esar

The topic of this week's newsletter and commentary is the reliability of predictions based upon statistics. Ironically, we at Financial Planning Perspectives have recently had an unexpected reminder of how valid predictions may - or may not - be. We depend on statistics to help us plan, yet they still can throw us for a curve now and then. Surprise, surprise...

Last week's newsletter was delivered to you this week because ***the stork*** made an early delivery to Matt's family... Baby was 4 pounds 15 ounces and, thankfully, both mom and baby are reported as doing well. Thank heaven for little miracles and medical technology! Our best wishes to Matt's family. Thanks for providing a fresh reminder, of how, when relying on statistics in everyday life, we sometimes get surprised.

A startling stock market "prediction" is discussed in Max's market update. Read a certain researcher's predictions for near term stock market performance, but bear in mind our eternal irreverence for crystal balls, and keep a jaundiced eye toward statistics when you are reading.

***"There are three kinds of lies: lies, damned lies, and statistics.\*"***

May all your surprises be happy,  
Sandra Heusinkveld  
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\*(Quotation attributed alternately to either Mark Twain or Benjamin Disraeli.)

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### Future Finances' Market Update

By Max Larsen

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Monday, May 17, 2004

In 90 days, I predict the S&P 500 will be up 16.8% and in 120 days, we'll see a 19.2% rise. No, I haven't turned clairvoyant and my crystal ball hasn't been talking to me. Before my compliance department has fits - let me explain. Jason Goepfert, a stock market researcher at Sundial Capital, has found a major historical correlation on all the days in the last 20 years when over 20% of all stocks trading on the NYSE made new 52-week lows (as they did on May 7th). He discovered that in ALL (100%) of the cases, the market went up during the ensuing 90 days and 120 days. The average gains have been 16.8% in 90 days, and 19.2% in 120. Let's remember to mark our calendars and see if the 100% is still accurate.

For the week, the stock market tried to take a stab at a recovery only to close with a loss for the third week in a row. Fortunately, the losses were minimal with the Dow, S&P 500 and Nasdaq forfeiting only 1.00%, 0.03% and 0.07%, respectively. As with prior weeks, investors are still concerned about rising interest rates, higher inflation, escalating energy prices and developments in Iraq.

I understand these worries but believe most of concerns are already priced into the stock market. Why do I think this? Let's review interest rates and oil separately.

#### Interest Rates

The Federal Reserve is greatly misunderstood. Contrary to popular belief, they don't control the economy. They don't create jobs. They don't balance the budget. They can only expand and contract the money supply by changing the cost of borrowing between financial institutions. Right now, according to the Federal Reserve Bank of St. Louis, key supply measures show very few signs of fast growth, a common sign of inflation. So what's the concern?

Consumer and wholesale inflation climbed higher than expected in April. Many are now anticipating the Fed could be forced to either increase rates by 25-basis points (1/4%) in June or by 50-basis points in August. If doing this helps control inflation, what's the problem? We all understand interest rates are at 46-year lows and will have to increase sooner or later.

Interestingly, stocks fared better than many people might think in the eight periods of Fed rate increases since 1971. According to a *New York Times* article, "In six of the Fed's rate-tightening episodes, the S&P 500's index was higher a month after the Fed stopped raising rates than it was before the central bank started tightening." How could this be? The stock market actually went up? Inflation is a much greater enemy than slightly higher interest rates. The interest rate increases are the medicine (which always tastes bad) that creates a cure for the inflationary disease.

#### Energy

As I always say - bad news sells a lot better than good news. That is why we're inundated with news about oil and the high price of gasoline. It is something we are faced with on a daily basis so it makes great news. The fact of the matter is \$40 per barrel of oil is not that big of a deal. First, it has been estimated (*Wall Street Journal*) there is between a \$4 and \$8 terror premium priced into oil. It is reasonable to expect the price of oil will decline as we approach June 30, the date the U.S. is expected to hand over the control of Iraq. Secondly, oil is not as expensive as we are led to believe. Adjusted for inflation, the highest we've seen oil is in excess of \$57 a barrel, yet no one mentions that on the news. Instead we hear: 'The price of gas has hit new highs!'. Baloney!

Finally, according to Ian Shepherd at High Frequency Economics, even at \$40 per barrel, the effect on the U.S. economy is only 0.5% of GDP. We, as a country, have actually grown a lot less dependent on oil than in the past, given our ability to produce goods more efficiently.

A little known fact is the government makes more money on oil than the industry itself. According to the National Center for Policy Analysis (NCPA), the major oil companies earned \$50.8 billion in profits during 2001, and the government collected nearly \$78 billion in taxes from them! What few realize is 26% of the price of gasoline is made up of taxes. However, when you include all of the taxes on the industry (income, excise, etc.), the NCPA estimates 42% of the cost of a gallon of gasoline is made up of taxes. Since we use about 370 million gallons of gas each day, our friendly politicians are raking in anywhere from \$182 million to \$295 million per day!

#### Conclusion

Things are actually not that bad right now. Most of the negative news is out and it certainly appears as if it is already priced into the markets. Let's hope Jason Goepfert's predictions are correct.

Have a wonderful week and I'll see you next week my friends.

*Thanks to friends like you who refer new business to us, our practice continues to grow.*

As always, your comments and reactions are welcome. Please feel free to share this newsletter with others you think may find it interesting or useful. We respect your privacy and will not share your address with others. Click [here](#) to send a comment, to subscribe, or unsubscribe.

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