Memo to: Oaktree Clients

From: Howard Marks

Re: How's the Market?

April 5 was just another ordinary day in the market, with big gains achieved and records broken. The Wall Street Journal article about it on April 6 was ordinary too, like hundreds that have been written in this bull market. I was struck, though, by the way it told in just a few paragraphs the whole story of what's been going on.

Just another day - On the surface, the aggregate stock market numbers continued to be very positive, with the Dow up 175 points, or 1.8%, to a new record. The S&P 500 was up 2.1% and the Nasdaq Composite Index was up 2.7%.

Even on this day of huge aggregate gains, however, participation was still relatively narrow. Almost as many stocks were down (1,318) as up (1,695). Moreover, more stocks set new 52-week lows (81) than set new highs (73).

This reminded me about the reliance of the market on just a few issues: In the first quarter of this year, 18 stocks accounted for all of the 5% rise in the S&P 500, (that's right, the other 482 stocks averaged a zero return). 55% of the stocks in the S&P lost money, and the Russell 2000 index of second tier stocks declined 5.4%.

Follow the leader -- So the leadership continued to be concentrated, as everyone knows, in just a few stocks. Yahoo gained 22% on the day, and Amazon.com was up 9%. Although IBM rose 4%, it was overshadowed by America Online, which gained 11% and became the more valuable of the two companies for the first time.

Illustrating the mania for things Internet, an article in the next day's New York Times reported on . . .

> . . . last week's initial offering of Priceline.com, which allows customers to name their own price for airline tickets on the Web. After less than a year in business, during which it lost $114 million selling $35 million worth of tickets, Priceline.com is valued at $10 billion, more than the combined net worth of UAL's United Airlines, Northwest Airlines and Continental Airlines.

Indifference to valuation - The entire bullish article - 22 column inches long - omitted all mention of valuation parameters such as P/E ratio, EBITDA multiple or dividend yield. The bottom line is that many of the investors setting the prices in today's market don't care about valuation. I get no sense at all that the analysts and portfolio managers backing the large-cap growth stocks and Internet high flyers can imagine prices at which they would be mere "holds" or (heaven forbid) "sells."

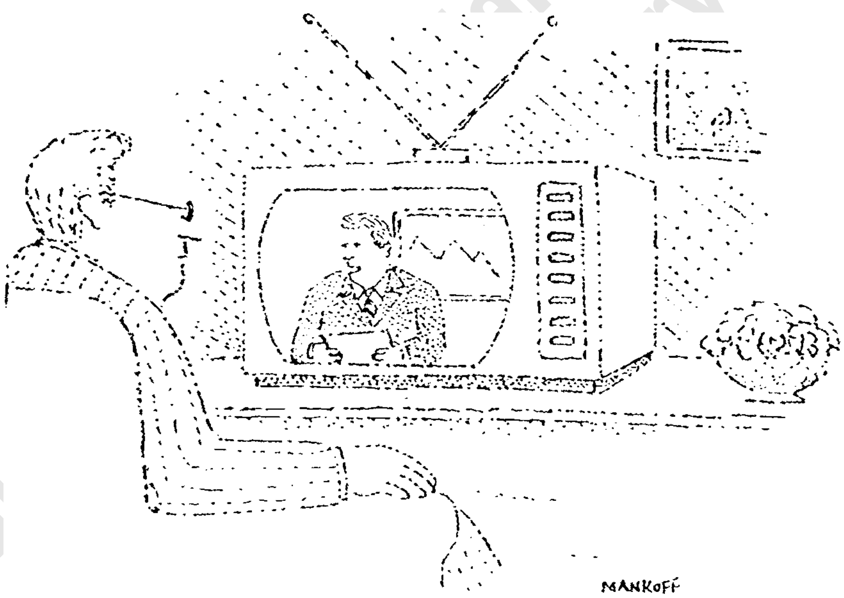
Looking on the bright side - The bulls - who are firmly in control - have joined with the media to interpret things in a positive light. I got a chuckle out of the article's description of investor reaction to the jobs data released on April 2:

> Those showed low unemployment, which was good for consumer spending; low wage increases, which implies weak inflation; and mild job creation, which implies a growing but not overheating economy.

I'm sure that in other times and climes, it would have come out this way instead:

> Those showed low unemployment, which carries a threat of renewed inflation; low wage increases, which implies an anemic economy; and mild job creation, which presages weak consumer spending.

Of course, economic developments are always subject to varying interpretation. The above passage sent me to the archives for one of the absolute classic cartoons:



"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

Drawing by Mankoff: @ 1981
The New Yorker Magazine, Inc.

Something for everyone (but little genuine debate) -- As the article reported,

> Wells Capital last week urged clients to move money into stocks from bonds, shifting holdings to 70% stocks and 30% bonds, from 65% and 35% . . .
>
> Taking the opposite approach to Wells Capital, . . . Bear Stearns urged clients to cut their stock exposure to 55% from 60% of their portfolio, moving the money into short-term cash accounts.

As for me, I'm certain one of them will be proved right.

Weak underpinnings - The article reflected the bulls' preoccupation with things that either don't really matter in any fundamental sense . . .

> . . . people are buying cars, they are buying houses, they are spending money. . . I think the wind is still at the market's back.

. . . or say absolutely nothing about long-term value:

> The whisper today was that the online firms are going to have very strong earnings.

Gobbledegook -- Lastly, some of what's going on just makes no sense at all.

> People are very comfortable that the earnings projections are going to be hit, but the expectations are higher than that.

I have no idea what that means, but I'm sure it'll be good for a few hundred points on the indices.

* * *

Lots of sound and fury, signifying nothing. There's a lot said, in the article I'm writing about and in the media generally, but not a lot of insight. And a lot of money being made, but most of it by the few most optimistic and aggressive investors.

The "rational" value investors have been decrying the excesses of the market for years – myself included. I've never felt more strongly the truth of the saying I picked up in the 1970s: "being too far ahead of your time is indistinguishable from being wrong." But as they say, "that's my story and I'm stickin' with it."

April 15, 1999

P.s.: Another Journal story on April 9 was equally illustrative of the times, but with regard to the flip side. Rather than describe the great success of the few on-line stocks, it recounted the tribulations of a more typical company without ".com" in its name.

It told the story of Computer Outsourcing Services, Inc. In the six years since it went public, its revenues have tripled and its earnings have quadrupled. But its stock has risen only 60%, less than a fourth of the gain in the Nasdaq Composite over that period.

In the quarter ended January 31, 1999, earnings rose 14% on a similar gain in revenues. In response, Computer Outsourcing's stock was down 23% for the year to date, versus a 17% rise for the Nasdaq index.

The result: difficulty in hiring "whiz kids" who want options on a soaring stock, trouble having acquisition bids taken seriously, and a dispirited CEO. Let's ask him "How's the market?"

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