

# Marathon Strategic News

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## ➔ The U.S. Economy

In sharp contrast to what some commentators and analysts may be claiming, we believe that the US economy is continuing its robust expansion without signs of overheating. Analysts that rely solely on traditional economic analysis have been warning about the potential for an increase in the rate of inflation for two years. However, no real evidence of inflation has materialized (Producer Price Index is a proxy for inflation – third chart on the right).

## ➔ Why Isn't the Rate of Inflation Increasing?

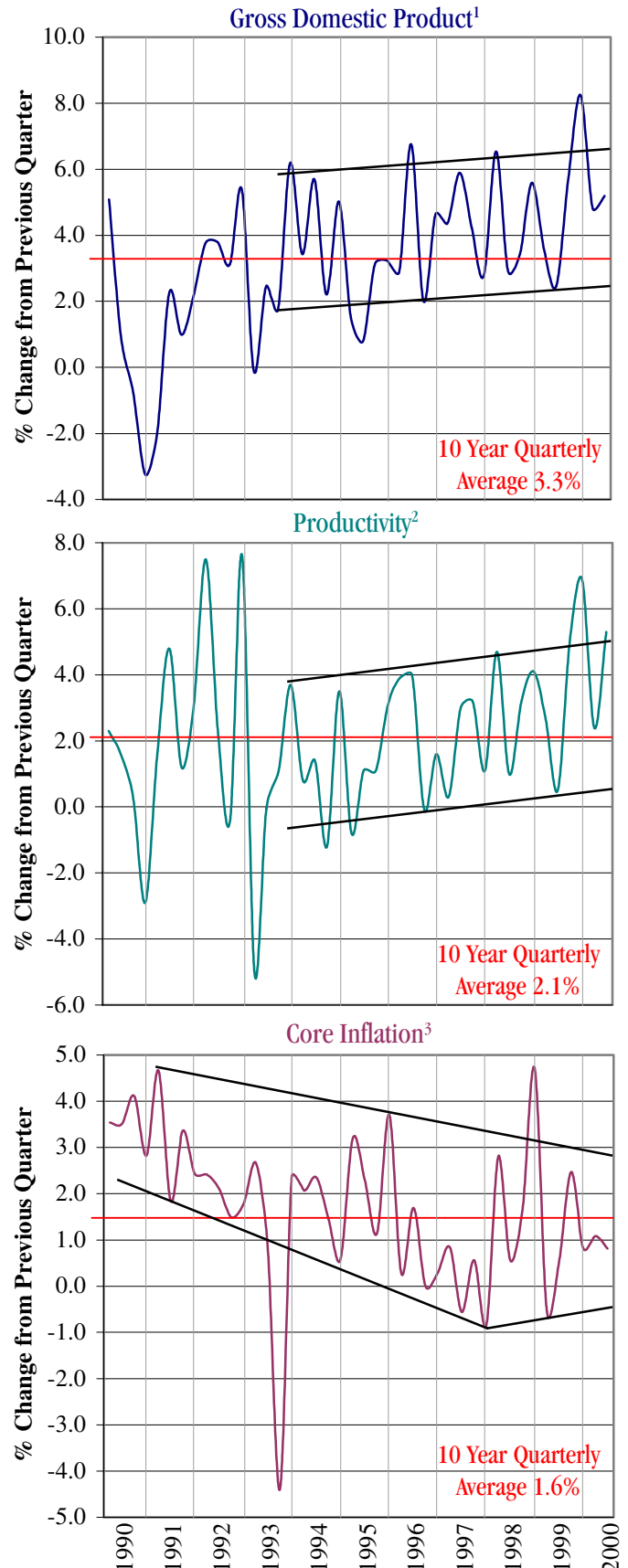
Traditionally in our economy, GDP has not been able to grow at a sustained annual rate above 3.5% without triggering an increase in the rate of inflation. In the first chart to the right you can see that the GDP growth rate has been gradually increasing to an average rate that is closer to 5%. If it appears that the economy is growing at an unsustainably high rate the Federal Reserve will increase interest rates to help curtail inflationary pressures. Since the beginning of 1999, the Federal Reserve has increased borrowing rates by 1.75%. This vigilance has definitely paid-off by causing the core rate of inflation to slow. The other important factor that helped increase GDP without igniting inflation was an increase in productivity (the middle chart to the right).

## ➔ Is the Increase in Productivity "For Real"?

YES!! The increase in our economy's productivity is genuine. Look around at what has changed in the world over the past ten years. Slowly but surely, the general population is learning how to integrate new technological innovations into their everyday workplace and personal lives. Usually, a lag exists between the development of a new technology and the time it is implemented in the mainstream workplace. People are still learning how to use the innovations that are being created in record numbers. Further, more businesses are investing enormous sums of capital into technologies that will increase their productivity. In short, we believe that we will continue to see productivity grow at a sustainable rate above 3% for at least five years.

## ➔ How will this Affect the Stock Market?

The price of a stock can be irrational in the short-term, but we believe the long-term price will reflect the fundamental value of the company. We feel confident that sustained levels in productivity along with other recent spectacular economic data will fuel a significant market rally. Whether it occurs in the third quarter, fourth quarter, or next year really doesn't matter for long-term investors. If anything, *the market volatility will continue to provide opportunities to invest in sound companies that have depressed short-term stock prices.* In summary, our long-term recommendation is to *remain fully invested in the equity market.* Remember to take all short-term market gyrations with a grain of salt.



<sup>1</sup>Gross Domestic Product - Real, Chained 1996 Dollars, Seasonally Adjusted, % Change vs Quarter Ago, at Annual Rate. Source: US Bureau of Economic Analysis.

<sup>2</sup>Productivity - NonFarm Business, Output per Hour, Seasonally Adjusted, % Change vs Quarter Ago, at Annual Rate. Source: US Bureau of Labor Statistics.

<sup>3</sup>Core Inflation (Core PPI) - Finished Goods Less Food & Energy, Seasonally Adjusted, % Change vs Quarter Ago, at Annual Rate. Source: US Bureau of Labor Statistics.