Gramercy Capital Management Corp.

This Market is Neither the OK Corral Nor the Y'all Come Back Saloon

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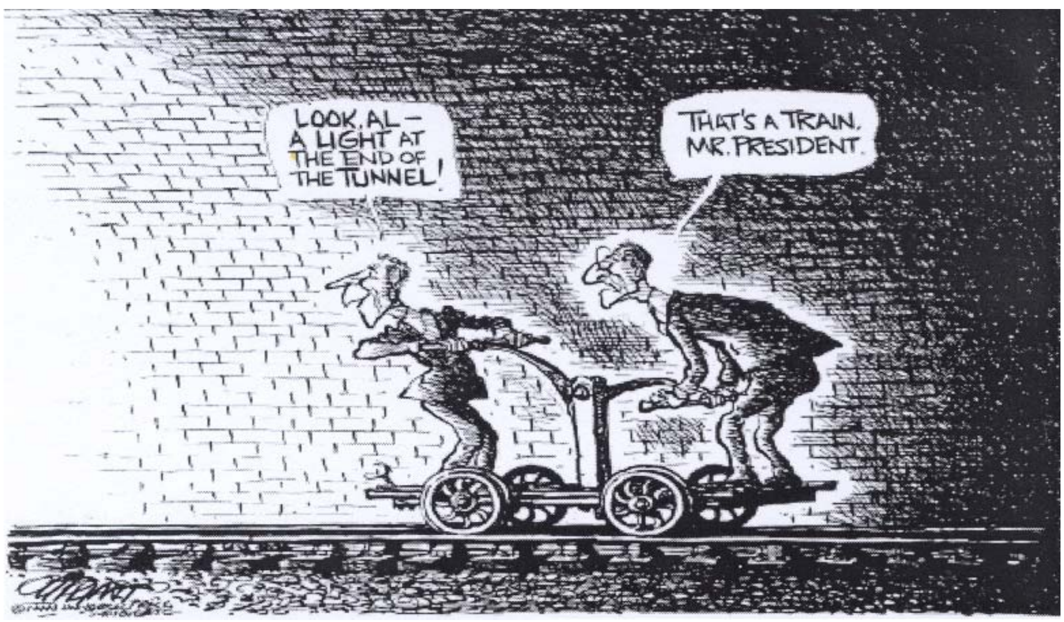
With President George W. Bush hanging out in Austin all of August, one couldn't help thinking about the Wild, Wild West. Well, really about this wild, wild stock market. Nothing is playing out as expected. The summer rally fizzled in June before the summer solstice arrived. Despite seven rate cuts by the Federal Reserve Board, the economy remains in the doldrums. The Fed has been pumping money into the financial system like mad, but it doesn't yet seem to be helping. Business is not improving. The consumer is showing signs of fear and increasing savings more than spending. Despite 55% approval ratings for El Jefe (the President), the CNBC economist Larry Kudlow recently pointed out that Bush can only blame the "downturn" on Clinton for a few more weeks. Soon, Mr. Kudlow contends, it will become Mr. Bush's recession to own forever. At that point it will be like father, like son!



You don't have to be a cow some cowpoke has just rounded-up to feel that you have already been roped, branded and shipped off to the slaughterhouse. Just open your brokerage statement and you know how serious this downdraft has been. There is no levity in that. There is never anything funny about losing money. The closer you are to planned retirement, the more worrying the problem.

Let's Look at the Economy

The positive factors: Unemployment remains quite low by historical standards. Helped by low interest rates, now hovering at 3%, the housing industry has remained strong. By refinancing their homes, many consumers are now enjoying smaller mortgage payments. Energy costs have recently abated. The 2001 tax bill has lowered income tax withholding levels. Coupled with the recent tax refund, Mr. Bush's best hope is that both will spur additional increases in shopping. Many retail stocks have performed well this year until recently. Perhaps the $300 refunds will help save Christmas for the retailers but it is no longer a sure thing.

The negative factors: The U.S. economy has not yet staggered into recession but it is only a hair's breadth away with GDP growth hovering just above the zero line. Consumers have carried the ball until now but may rapidly be losing the will to shop. People have become far more concerned about job security than they were a year ago. Recent savings numbers seem to indicate that people are spending less and saving more for the rainy day they fear may soon be upon them. Hiring freezes are widespread and more lay-offs are announced weekly as the effects of the downturn spread to more industries. Brokerage firms, for example, are laying off more people than they have in a decade as investment banking business has dried up and trading volume is weak.

Corporate capital spending ground to a halt almost a year ago. Businesses are still severely curtailing purchases of everything from new plants and equipment to computers, software, storage devices, and communications equipment. Many firms were oblivious to a decline in demand and kept producing products until long after demand collapsed. That is why Cisco, for example, recently had to write-off almost $2 billion in excess inventory, a staggering number.

Global Issues Must be Factored Into the Equation

Finally, remember that despite prevailing isolationist views, our economy is closely intertwined with almost all others around the globe. Even as other areas of the world faltered economically in recent years, the U.S. pulled the wagon of global economic growth. Softness is now appearing in the economies of many of our trading partners. Don't disregard the discomfort our N.A.T.O. allies feel with current U.S. foreign policy. It may continue to affect the value of the U.S. dollar and make our stock market less attractive to foreign investors, too. The Middle East is a tinderbox that cannot be ignored.

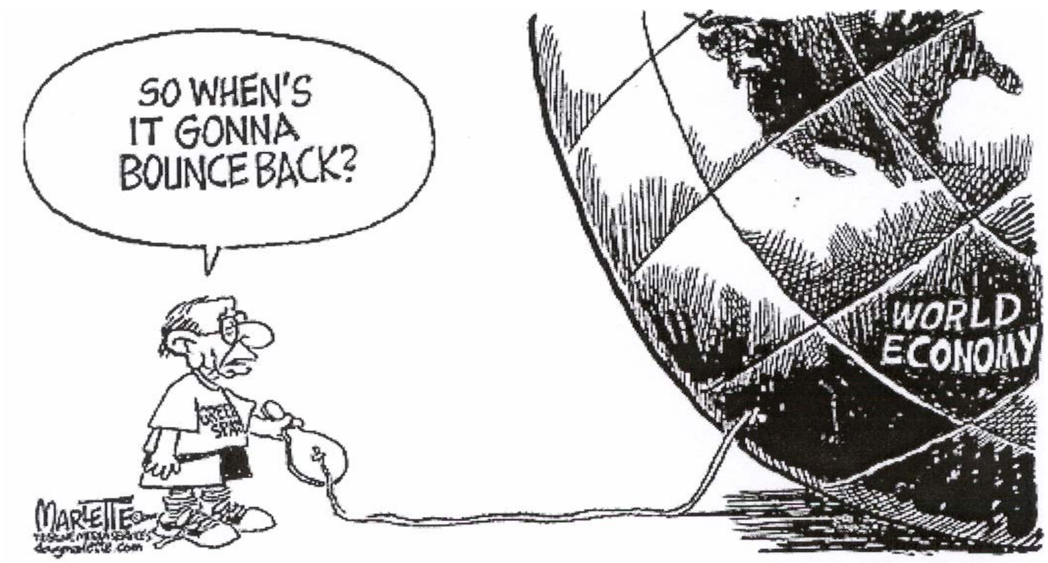
Mapping a Strategy Now

Gramercy Capital believed that the market bottomed in late March/early April. It may well be that current action will be a successful retest but with the global economy now turning down that is less clear. The significant bounce in April and May rewarded those who spotted the spring capitulation. Since June, however, the market has taken a decidedly nasty turn as economic numbers have become more alarming. At this moment, caution is still warranted. Be sure you own quality companies with plenty of cash and little debt on their balance sheets. Avoid companies that are using phony "pro forma" accounting to keep up appearances when real accounting rules would have their real earnings look dismal like Computer Associates. Don't try to hang in there with marginal companies whose stocks have collapsed. This is not the time to own junk.

What's the incentive when the best companies are on the bargain table? Also avoid purchasing stocks selling near their highs for the year. You're too late to their party.

Recently, 62% of all stocks on the NYSE have been selling above their 200 day moving averages. That number is way too high for a market bottom. That means that many companies that have held up thus far in the rout just haven't yet had their turn in the barrel. This correction isn't likely to be over until they do. In 1990,the market bottomed with 9% of stocks above their 200 day moving averages. A more typical bottoming number would fall in the twenties. If the consumer shuts down his spending and unemployment starts to rise significantly, retailers, service companies, and financial stocks may well start to suffer, too, forcing that number to fall into line.

Eventually, inventories will be depleted and new orders will have to be filled with new production. The downward cycle will be reversed. There is so much cash on the sidelines that eventually there will be a stock buying explosion when those first trickles of light come down the tunnel. The big unknown is "When?" that will occur. Frankly, nobody knows the answer.



Gramercy Capital is a patient long-term investor in normal times. Twice this year we have chosen to take our cash position up to 40-50%, something we have rarely done before in all our years in business. Surely you can say, "But the horse is already out of the barn" and you are right following the worst rout in a generation (27 years). Prepare a first class list of stocks you want to buy when the market perks up. Make sure that list includes a lot of under-owned technology companies that are best of breed and financially strong. You can spot them by looking at their balance sheets and stock charts. Pick companies that are truly leaders that will not be overtaken by lower cost competition or better mousetraps. For that determination, you might need to seek professional help with your portfolio.

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