Risks and Rewards Newsletter

August 1999 – Issue No. 33

1999 Market Triathlon Update

by Frank Grossman

Twenty-nine intrepid Investment Section members submitted entries postmarked before the June 1 deadline to the 1999 Market Triathlon contest. While the majority of missives were received from the United States and Canada, far-flung actuarial outposts in Hong Kong and Malaysia also checked in. Hence, distance alone can't reasonably be held as an excuse by those Section members who failed to submit their picks.

Recall that the Market Triathlon simply challenged contestants to set out their best estimates for the 3-month Treasury bill rate, 30-year Treasury bond rate and Dow Jones Industrial Average index value at year-end 1999—seven months in advance (a mere blink of the eye to those well accustomed to setting pricing assumptions). E-a-s-y! Where better to invest one's unallocated surplus, given that the price of a postage stamp confers a 7.25:1 shot at one of the four $100 event prizes?

In the five months since last year-end, treasury yields have risen while the DJIA continued its ascent (Table 1). Thirty-year treasury yields, which plunged to 4.6% last September in the wake of Russia's default and the Long Term Capital bail-out, rose above 6% in early June.

Our triathletes' outlook for interest rates at year-end 1999 was, on average, roughly a 25 basis point increase in short rates and little change in long rates compared to yields in early June (Table 2). The average DJIA pick submitted by our triathletes exceeded even Abby Joseph Cohen's year-end target released in late March. Though some might typify Ms. Cohen as an outspoken booster of the longest bull market in history, her pick for the year-end DJIA was only 10,300, representing an annual gain of slightly more than 12%. Wimp.

Table 1

Recent Historical Data

	3-Month T-Bill Yield	30-Year T-Bond Yield	DJIA Index Close
December 31, 1998	4.44%	5.092%	9181.43
June 1, 1999	4.56%	5.936%	10596.26

Table 2

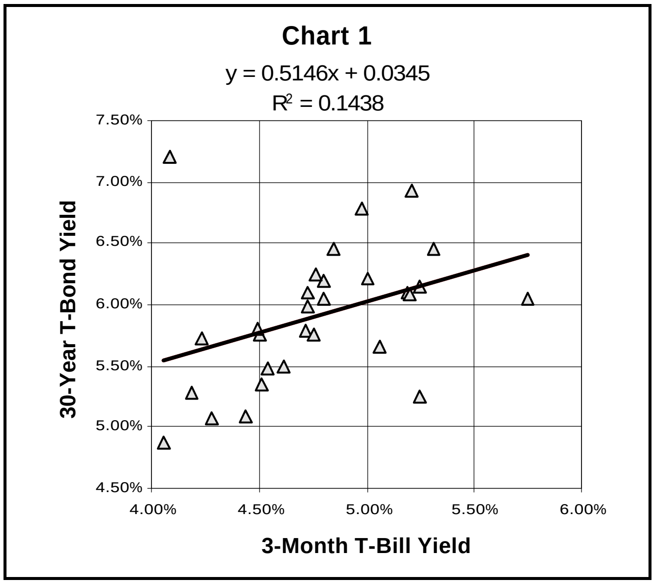
Key 1999 Market Triathlon Picks

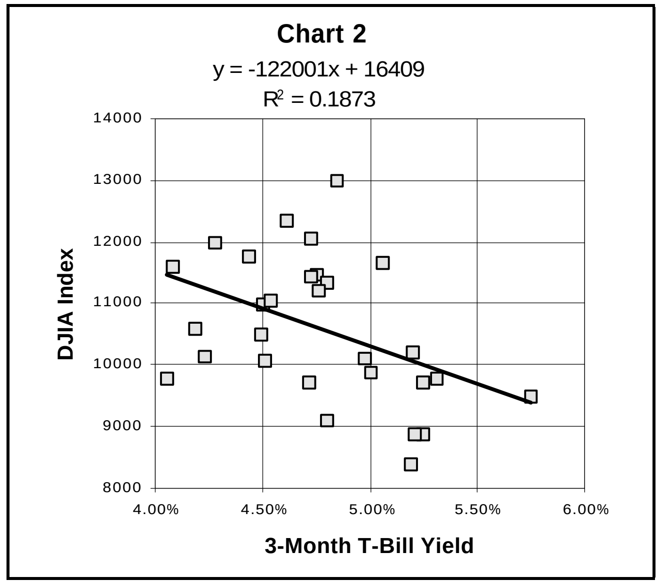
	3-Month T-Bill Yield	30-Year T-Bond Yield	DJIA Index Close
Maximum Pick	5.75%	7.208%	12980.00
Mean Pick	4.77%	5.908%	10591.00
Median Pick	4.75%	5.976%	10499.00
Minimum Pick	4.06%	4.868%	8375.00

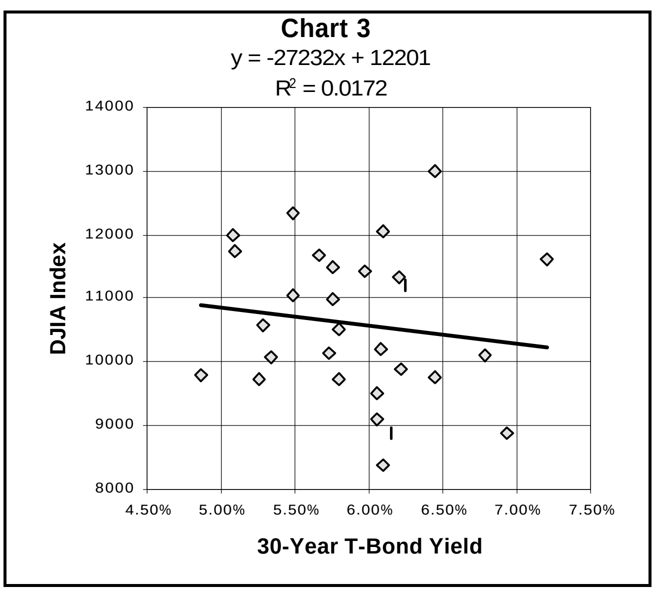
The pairwise scatter charts of Market Triathlon submissions reveal a positive correlation between short and long interest rate picks, and a negative relationship between the DJIA and interest rate picks (Charts 1, 2 and 3). The coefficient of determination of a linear trend line is very low in each case, indicating poor fit.

The outlook for price inflation is unclear despite buoyant U.S. consumer spending that's growing at a 4.5% per year clip. Americans are spending more than they take in as earned income, with the more fortunate ones making up the differential via stock and residential housing-market gains (the so-called "Wealth Effect"). While over 40% of households now have investments in shares, roughly double the proportion in the early 1980's, *rich* Americans have been selling their direct equity holdings of late. (Hmmm … this may very well be a lesson in how to stay rich.)

Year after year, the psychology of the market has undergone a *volte-face*: while deflation was the perceived threat last summer, a state of "apprehended" inflation currently exists. Should a round of higher interest rates be required? Can the central







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bankers lift their collective foot off of the accelerator without tamping the brake? One can only begin to wonder how fragile share valuations are at this point.

One thing is crystal clear: the fancier U.S. Federal Reserve Board Chairman Alan Greenspan's words on the subject of interest rates and markets are, the more important (and obscure) his message. Mr. Greenspan describes his technique as "mumbling with great incoherence" and one can only take him at his word. Remember irrational exuberance? American equity markets haven't looked back since that famous utterance. Consider his June 30 statement coincident with the announcement of a 25 basis point increase in the federal funds rate to 5.00% (offsetting by a third the cuts undertaken last autumn):

> Owing to the uncertain resolution of the balance of conflicting forces in the economy going forward, the Federal Open Market Committee has chosen to adopt a directive that includes no predilection about near-term policy action.

"Americans are spending more than they take in as earned income, with the more fortunate ones making up the differential via stock and residential housing-market gains."

Hence the famous "neutral stance" that has accompanied each Fed rate increase this decade and is code for no further rate changes in the immediate future (no surprise). Thirteen days earlier, Mr. Greenspan told Congress about an "unsustainable trend that has been produced by an inclination of households and firms to increase their spending beyond the gains in their income from production," thereby telegraphing a modest increase in interest rates that was subsequently "fully discounted" by financial markets (no surprise). Yet, when news of the rate increase broke at 2:15 p.m. ET, the DJIA leapt up 200 points and the benchmark 30-year treasury yield fell from 6.07% to 5.96% (surprise). Efficient markets truly move in wonderful ways.

What's to be done in the interim, while we wait for the results of the 1999 Market Triathlon? Well, the Federal Open Market Committee (FOMC) has meetings scheduled for August 24 and October 5 that you might wish to mark on your calendar. Or you might just go to the beach instead.

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Your Book Purchase Can Help the Profession

Through an arrangement with amazon.com, your purchase of a book or CD from that Web site can add to the fund that encourages qualified minority students to enter the actuarial profession. This arrangement was made soon after the March/April 1999 issue of *Contingencies* magazine produced by the American Academy of Actuaries featured a cover story by Robert Randall. He was the first African-American Fellow of the Society of Actuaries, and the article told of his experiences as a pioneer black actuary and the instigator of the SOA's minority recruitment program. Randall's article received a tremendous response, with many letter writers agreeing that the profession should do more to encourage minority recruitment.

At about the same time, *Contingencies* editor Steve Sullivan signed an agreement with bookseller amazon.com to allow readers to purchase books directly through the *Contingencies* Web site, ***www.contingencies.org.*** Under the deal, *Contingencies* receives 15% of the price of books reviewed or recommended in the magazine. *Contingencies* receives 5% of the price of all other books and CDs purchased. *Contingencies* has agreed to contribute 25% of all revenues earned to the work of the CAS/SOA Joint Committee on Minority Recruiting. Since 1977, this committee has been funding scholarships for qualified African American, Hispanic and American Indian students interested in actuarial science. It awarded $29,500 in 1998 for scholarships and also contributed to several summer high school actuarial programs at universities.

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