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Calling the Crash: Pessimistic Predictions By Analyst at Shearson Make Her a Star

DESPITE being right about the market crash, Ms. Garzarelli describes last week as one of the worst of her life. 'I've been having heart palpitations,' she says. 'I thought I was having a heart attack. It was anxiety.'

Elaine Garzarelli

YOUR MONEY MATTERS

By JAMES B. STEWART
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Robert Prechter, Joseph Granville and Henry Kaufman: meet Elaine Garzarelli.

Ms. Garzarelli, a research analyst and money manager for Shearson Lehman Brothers Inc., turned bearish on Sept. 9. By Oct. 12, when she appeared on Cable News Network's "Money Line" program, she was fiercely bearish, predicting an imminent collapse in the stock market. She gave USA Today a similarly dire forecast the next day. Then, she says, "I hid."

In the wake of the Oct. 19 market collapse, she has emerged as the newest star prognosticator on Wall Street. Two days ago, she issued a bleak forecast to already shell-shocked Shearson brokers, warning that the Dow could drop as low as 1300 within a week. Her prediction—backed by her sudden credibility on Wall Street—was widely cited as one of the reasons for this Monday's 157-point rout in the market.

Putting Her Money . . .

Ms. Garzarelli's forecasts are all the more impressive because she acted on them in the mutual fund she manages for Shearson, the Sector Analysis Portfolio. Heading into the Oct. 19 crash, the fund, with $600 million under management, was 50% invested in cash, 40% in two-year Treasury bills and 10% in stock puts, or rights to sell shares at a certain price in the future, which increase in value if the stock price falls.

The sector fund, launched with a net asset value of $12 a share on Aug. 27, stood yesterday at $12.47—one of the few mutual funds concentrating on equities to have gained in that period. According to Michael Lipper of Lipper Analytical Services, Ms. Garzarelli's fund gained 5% last week. Among comparable funds, only Paine Webber Inc.'s Asset Allocation Fund did better, with a rise of 6%. (Among all mutual funds, 67 outperformed Ms. Garzarelli's last week, but nearly all of them were invested in bonds, Mr. Lipper says.)

Yesterday morning, working from the sofa in the Greenwich Village apartment she uses as an office, she fielded a flood of phone calls. As her big-screen television flashed ticker quotes indicating a rally, she remained bearish. "Sell into this rally," she orders a caller, no hint of doubt in her voice. "It's going much lower."

Some callers are angry, blaming Ms. Garzarelli for this Monday's collapse. "No one individual affects the market," she firmly tells one customer. Several Shearson brokers, too, were furious about her Monday morning forecast. Ms. Garzarelli says she made it reluctantly, at the behest of her research superiors at Shearson. "I hate being bearish," she says.

Jack Rifkin, head of research at Shearson, says Ms. Garzarelli isn't eager to be known as a market seer. "She doesn't want to be seen as an alarmist," he says. "She's very straightforward, and she relies on these very mathematical indicators. She doesn't try to forecast the indicators, she's just honest about what they say."

Despite predicting the crash, Ms. Garzarelli describes last week as one of the worst of her life. "I've been having heart palpitations," she says. "One morning last week I actually called an ambulance to the apartment. I thought I was having a heart attack. They said it was anxiety."

Watching the deterioration in the stock portfolios of clients who didn't fully embrace her bearish forecast, she says, is like "having your mother die." Ms. Garzarelli is slender, animated and looks younger than her 36 years. But after last week, she says, "I feel like 50."

Bearish Indicators

Ms. Garzarelli's methods involve complex mathematical computations—she's been Institutional Investor magazine's top-ranked quantitative analyst for four years running—but she concentrates on fundamentals. She keeps a running tally of 13 indicators, three tied to the economic cycle, seven monetary factors and three valuation measures, including yield ratios between stocks and bonds.

On Sept. 9, when she first issued a bearish report, Ms. Garzarelli's indicators had turned 75% negative; by Oct. 12, they were 92% bearish, the most dire forecast her indicators had produced since she began such computations in 1980.

These indicators shape her outlook on the direction of the overall market, which she believes is the most important factor in stock-market investing. Of nearly equal importance, she says, is so-called sector analysis—computations to determine which industries and groups of stocks are likely to perform better than others. She is comparatively uninterested in individual companies, believing that company performance accounts for only about 10% of the movement in a stock's price.

Despite her recent forecasts, Ms. Garzarelli sees the recent collapse as a correction, albeit a steep one, and remains fundamentally bullish. "After the next slam down," which, she says, is imminent despite yesterday's gain of nearly 53 points, "I see a rally of 30% to 50% over the next four months." She expects it to be broad-based, diminishing the importance of sector analysis. But she expects interest-rate-sensitive stocks—utilities, savings and loans, home builders and auto makers—to post the biggest gains.

Ms. Garzarelli has seen other downturns. She started as an economist at A.G. Becker in 1972, after graduating from Drexel University, then moved to Shearson in 1984 when Becker was acquired by Merrill Lynch & Co. But this decline has been different, in part because she has been outspoken about her pessimistic views while many brokerage firms—most conspicuously Merrill Lynch—have been conducting campaigns to shore up investor confidence in the market.

"In '83 and '84, (the last period of sustained market decline), Becker would never let me be negative about the market," she recalls. "At Shearson they told me, 'Go out and tell the truth.' "