Yesterday was fun, wasn't it?

Thank you Shanghai for plummeting 9%. What? You don't think that giving back 9% after running up 200% is ok? Thank you lunatic terrorist (isn't that redundant?) for trying to cause a worldwide security scare. Thank you US Durable Good Orders for showing unexpected weakness. And finally, and most importantly, a big THANK YOU to all those idiots who sold only because prices began to decline, which caused more folks to sell, which triggered lower prices and on and on.

Now all the pundits can stop feeding us with that babble about the Dow going 7 months without a 1% down day and the market not seeing even a 2% pullback and the dreaded 10% decline hasn't occured since March 2003. Wait...scratch that last statement. The market didn't see a 10% decline yesterday, although you certainly would have thought so based on the talking heads' interviews on TV.

Truth be told, stocks were going to drop to these levels whether the Chinese market fell or an attempt was made on a world leaders life or the economics numbers were soft. All yesterday did was speed up an event that would have unfolded over a period of weeks, not hours. Yesterday's 4-5% decline was something I wrote about and forecasted last month. Clearly, I was wrong in my timing, but not the result. Yesterday was the first building block in what I believe could be a near vertical ascent to a mountainous peak in equities once the weather warms. And to give you a hint of the eventual outcome, imagine being tossed from the top of Mount Everest, without a parachute!

Tuesday's action was not without precedent. There have been several cases where volatility, downside movement in plain terms, expanded so immensely after such a long, quiet period. It led to more volatility in all cases almost immediately. That means, the market is going to make another large move right now. While the odds favor a sharp rally in the next week or two, there have been two cases when the market continued its downward path immediately in crash type action.

Here are some reasons why I believe a rally will be the path:

1- Markets typically do not collapse from all time highs so quickly and in waterfall action. It takes much more time.

2- Record volume during downdrafts is characteristic of lows, not the beginning of meltdowns.

3- Tuesday's behavior was classic bull market, stair step, measured rallies with short, steep and hair raising declines.

4- CNBC started running special segments called "Prepare for the Bear". Guests were calling for the beginning of the much awaited 10-15%. These people are NEVER timely in their calls.

5- The current market looks very similar to October 1997 on a much tamer scale. (I will email around charts if you want to see this graphically) At that time, the S&P was scoring new highs and the NASDAQ was chopping sideways. The news backdrop was called the "Asian Contagion" as emerging markets melted down in a currency related crisis. The Dow dropped 584 points that fateful day, the most ever at that time, only to rebound the very next day in the largest rally ever at that time. The NASDAQ's rally lasted only one day and spent the next few months digesting before exploding higher.

Where we are now...

Late last night, I called and emailed every single client to let them know where our strategies stood and what the plan was for today. I also reiterated what they (you) already knew. We have a solid, stable and robust investment process that has stood the test of time in almost all market climates. As you know, I am not a complacent manager who lets everything sit until it's too late. I believe in being proactive in both my communication and my investment process. That's one of the primary reasons our returns have been so stellar.

My preferred scenario for today, Wednesday, would have been for another nasty opening to clean the whole mess up. Alternatively, if the market screamed higher, it would have made selling at the close very easy and comfortable. The toughest path is exactly what occured, a gap higher at the open followed by a feeble rally. It's tough because it leaves too many open short-term trading paths. The market could continue higher for a few days and then head down, or the rally could be over and stocks revisit yesterday's lows in the next few sessions.

What we did on Tuesday...

This morning, as you can imagine, my inbox was full of emails with questions about how we reacted yesterday and what we did. First, we did NO SELLING. We used the early weakness to lightly buy with much more being commited at the close. We also moved from a more defensive equity exposure to more aggressive in the middle of the day. We will be very proactive to seek appreciation, but not expose our portfolios to undue risk.

Where the markets are heading...

Over the next few weeks to months, I believe the markets will quickly regain their old highs and head higher. There SHOULD be one more shoe to drop to shake out more people and build up significant fear. That may mean a full break of Tuesday's lows! BE PREPARED FOR MORE WILD TRADING DAYS AND VOLATILITY!

Nimble investors and traders should be salivating right now at the prospect of movement in both directions. This is where the real pros rise to the top and the pretenders exit the business. I urge you to seek the help of a professional. You worked hard to amass your portfolio and the market's been easy since the summer. Those days are now a distant memory and the margin for error is slim right now.

Please feel free to contact me directly via email or telephone to schedule some time to discuss your portfolio. The email is free, but the information is priceless!

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If any of our emails bounce back to you, please forward to Paul@bcmoney.com. Our IT staff is working on the issue.