June 25, 2007
7:43 am

Topics Include...

Stock Market in the Bottoming Process
Intermediate-term Looks Solid
Disbelief Still Rampant
Signs Before a Top
International Exposure

Stock Market in the Bottoming Process

We left off a week ago with a stock market that was bouncing higher, but I was "not convinced the next surge higher was immediately upon us". Rather, it looked as though the market was in for another 1-3% dip into this week and the Fed meeting. And that's almost exactly what's been occurring!

The sell off we saw last week should continue early this week, culminating in what could be the final solid trading bottom in this bull run. Worst case, it looks like there is another 1-2% on the downside for the major indexes, but I would definitely not hold your breadth, as the landscape looks just too good over the next month or so for stocks and we are getting very oversold in the short-term.

Intermediate-term Looks Solid

As we have seen since the lows in March, "smart money" continues to own stocks, especially on dips and "dumb money", which has a permanent skew to the long side, has been as underinvested as they have been since the bull market began. This is very positive over the intermediate-term.

The recent Barrons mid-year roundtable revealed one of the dourest collective views I can ever recall during a bull market. This group certainly is known for their market timing prowess! Score that as another solid positive over the intermediate-term.

Besides being short-term oversold, I love seeing scary headlines near market bottoms. The recent Bear Sterns hedge fund debacle certainly qualifies to go along with heightened tensions in the Middle East.

I firmly believe that the market is going to establish a low long before Bernanke & Co. announce they are leaving rates unchanged at 2:15 pm EDT this Thursday. My interest stance remains unchanged from the past few months; the Fed will be on hold for all of 2007 unless the stock market declines more than 10%, in which case they will cut rates ¼%.

Disbelief Still Rampant

I can't tell you how many people continue to disbelieve the power of this bull market. Judging from the number of critical emails I receive each week when I reaffirm my bullish stance or the skeptics in the media when I am interviewed, there are an awful lot of outright bears or very underinvested bulls in investment land. Granted, the sighs and laughter aren't as great when I offer my forecast as they were in early March when I called for an immediate rally to new highs, but they are still vocal.

Each successive pullback/dip over the past few years has been met with more aggressive "Johnny Come Lately" buyers who have greatly lagged the overall market's performance. This is easily seen in the severity of each decline since the bull market began in 2002. We saw a 10% correction in 2003, just about that in 2004 and a bit less in 2005. 2006 saw an 8% affair, while March of this year was only 5-6%.

Signs Before a Top

As we build toward the final peak, perhaps this summer, I expect the June 2007 dip to be less than the March 2007 one and fall in the less than 5% category. You can almost feel the mutual and hedge fund managers scrambling every time the decline ends and strength resumes as their hopes of a double digit decline to catch them up goes out the window, again! This is eerily similar of the behavior during the final rally in 1987, 1990 and 1998.

If we are, in fact, building toward a significant stock market peak, I expect a few things to materialize. First, the New York Stock Exchange advance/decline line, a gauge of overall market health, will not follow prices higher in July. Second, credit will continue to tighten, making money harder to come by, and the spread between guaranteed treasuries and junk bonds will widen to begin to account for repricing of risk.

The fallout in the credit market will have an immediate impact on the recent takeover boom, fueled by private equity (PE). It certainly is no surprise that the king of PE, Steve Schwarzman and the Blackstone Group, went public on Friday with an astronomical valuation. And it looks as though KKR and Apollo Group will follow King Steve with IPOs before year-end.

My friend Jim Lane is always on the lookout for the "seminal" event to change the investing climate and in the PE case, it will be the inability to get a major deal done. Right now, there are rumbling about the First Data deal, but it's unlikely that this will be the one. Rather, First Data is the shot across the bow to warn us of a change on the way.

International Exposure

As I have mentioned a few times, our two new international strategies are set to launch one week from today. The Developed Markets Program will focus on the more western markets, like Great Britain and Germany, while the Emerging Market Program will look at the more volatile stock markets, like China and Russia.

If you are looking for international exposure and can accept the volatility, these are two strategies that offer tremendous potential reward for those that have at least a moderate risk tolerance. You must be aggressive to invest in the Emerging Markets Program.

Additionally, as we have discussed before, we will charge zero management fees for the first quarter as an incentive to try a new strategy. If your portfolio needs some international flare and you want professional management, please contact me directly to discuss. The minimum investment is $100,000 and this is good through this Friday, June 29.

As always, please feel free to contact me via email or phone with any questions or comments.

All Good Trades,

Paul Schatz
President
Heritage Capital LLC
1 Bradley Road - Suite 202
Woodbridge CT 06525

203.389.3553 phone
203.389.3550 fax

www.InvestForTomorrow.com

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