September 17, 2007

11:18 PM EDT

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BOOM... thump

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When I came home from the office tonight, my two year son saw my car come down the driveway. As I opened the door to the house, I heard him calling "Daddy! Daddy!" as he tore around the corner from his room, heading towards the kitchen, his "blankie blue" in one hand and a Curious George stuffed animal in the other.

The next sounds I heard were "BOOM...thump" as he stepped on his blanket, tripped and went down hard on the wood floor, falling on his back and hitting his little head. "Wait for it", I said to my wife, assuming the scream would follow. And oh boy did it! With giant size tears to boot.

He stood up and ran over to us as we waited in the kitchen. After distracting him with the elephant that was walking down the street, the crying quickly ended and the world was a great place again. You think he would finally learn? Nah. When his tubby was drawn and ready, our little terror, once again, came flying around the corner, this time with milk in one hand and a book in the other. Same result.

Do investors have the same habits as two year olds?

I think so!

Will They EVER Learn???

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It's been just about one month since the stock market bottomed in true panic form. I vividly remember the day as I was hesitant to even stand up from my desk and go to the bathroom, let alone pick up my lunch, for fear of missing something. It was that crazy... and fun!

As the Dow plummeted to more than 400 down after hard selling the previous few days, I knew one of two scenarios would unfold. We would either immediately crash or the rescue squad would have to make a dramatic stand. As we found out within a few hours, it was the latter.

During that final swoon to the August 16 lows, record volume was seen. That wasn't just your neighbors panicking, but institutional money as well, selling precisely at the wrong time. It was the proverbial herd of elephants all trying to squeeze out of the door at the same time, to stir up an old analogy of mine I used to use at seminars.

I just shook my head in disbelief when my inbox was bombarded with emails and my phone rang and rang, all from non clients wanting to know if it was a good time to sell.

It seemed very familiar to the March bottom, which was inspired by a Chinese sell off and sub prime blanketing the news. At the March lows, our investment models turned as positive as they ever get, moving clients to full stock market exposure across several key indexes.

And four months later, as almost all of the major indexes soared to repeated new highs, earning our clients some truly outstanding returns, our intermediate-term model turned negative, the very day the Dow closed above 14,000, preserving those gains and even profiting during the ensuing decline in some strategies. Coincidentally, it was also the same week I was inundated with requests from prospects to learn more about becoming a client!

Why do investors continually buy AFTER major rallies and sell into corrections???

Will they EVER learn?

I am amazed at just how short their memories are! It reminds me of my son! I often joke with my wife that our little guy, after repeated spills and falls, could do no worse than some of the high priced mutual fund managers out there.

What's interesting now, is that only a month after the sharpest decline in 4+ years, the investing public has almost totally forgotten the July - August correction. Guest after guest on television now cops out about seeking to buy for the next 10 years, not 10 months. Truth is, what else could they say after seeing their portfolios evaporate in only four weeks?

I don't buy the 10 year argument. It's 100% hot air. Go talk to the suckers who began to invest in late 1999 and 2000 how they feel about their 10 year plan! Watching 40 - 80% of their portfolio immediately go to stock heaven!

Let me be crystal clear. Folks hire me to worry about the next 10 hours, 10 days, 10 weeks, 10 months, 10 quarters and yes, 10 years. Why on earth would you turn your money over to someone who wasn't concerned about the immediate future? That makes no sense!

It pains me at just how complacent investors are when hiring an investment adviser. I simply cannot understand how mediocrity is an accepted practice.

Let me step off the soapbox and back to the stock market. With so many people having amnesia and stocks rallying so hard into the Fed meeting, risk has certainly increased a lot. Until Bernanke & Co. cut rates in a few hours and the initial reaction wears off, I do not think there is an edge in the market. It looks like we've reached a temporary period of equilibrium.

Lots of Pressure on Big Ben

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At 2:15 PM EDT on September 18, the Fed is going to cut interest rates by at least 1/4%. That's almost a certainty, especially with that bizarrely weak employment report earlier this month and the continued credit crunch.

1/4% is what the market has priced in, at a minimum. In the extremely unlikely event the Fed leaves the Fed Funds rate unchanged, I would expect an immediate and swift negative reaction from stocks for a few days to a few weeks that should revisit the bottom we saw on August 16. Yes, it would be that ugly!

If Bernanke cuts by the expected 1/4%, I would imagine we see a negative reaction over the coming week, even there is a brief rally.

Should Big Ben & Co. do the unexpected and cut the Fed Funds by 1/2%, there should be an immediate period of euphoria, lasting a few days, but I still believe a short-term pullback follows.

The 1/2% cut has been begged for by a few CEOs, but that seems way too drastic for this more measured Fed. It would also be a sign that Bernanke admits economic panic, something I cannot see him doing since the evidence is not at that point yet.
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With the market rallying so hard from the August 16 low and many indicators at the neutral level, I would normally look for a more extended pullback at this point. And I still might, but the amount of the rate cut and statement are such wild cards that I will continue to play it very close to the vest.

We have some big performance numbers to preserve and I see no reason to push the envelope without our models backing that up. I will say this though. An extended rally of anything more than a few days will definitely catch me by surprise as I favor the downside. The market continues to have the feel of another shoe or two to drop and I do not think a rate cut will prevent that.

The major brokerage firms begin to report earnings in the morning with Lehman and they should have some nasty things to say if they really come clean.

As usual, it's getting late and I didn't get to talk about my thoughts on the Alan Greenspan media parade. I did, however, get to watch the Yankees continue their second half steam roller, beating their 2007 nemesis Orioles. And this edition only took me four innings to write!

Tuesday, and probably the rest of the week, is going to be a wild affair after 2:15 PM. With earnings, the PPI, CPI and options expiration on Friday, this is one week I would not miss for anything. OK, well, maybe the birth of another child. We'll have to wait until the end of March for that one as we are expecting an “edition” to the already crowded house!

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