STREET$MARTS

Dedicated to Growing and Protecting your Portfolio

October 31, 2007

9:22 AM EDT

Inside this issue

Here's What Bailout Ben Could Do

~~~~~~

In just a few short hours, Bailout Ben Bernanke & Company will release the Fed's decision on interest rates. Until yesterday morning, it was all said and done that we would see a 1/4 point rate cut. That was until the Wall Street Journal sent up a trial balloon of no move on rates. If you watched the markets' reaction, all you saw was a giant yawn.

I hope you enjoyed the past few days of quiet markets because that's about to change in a huge way. The major indexes are poised to see some violent reactions during the final two hours of trading that will likely spill over to Thursday and then Friday when the monthly employment report is released.

Right now, a 25 basis point cut is what is priced in and expected. Should we get that, the ensuing commentary from Bailout Ben will be read letter by letter to gauge future moves and opinions on economic growth, the state of the credit market and inflation. This scenario has a probability of about 80% and I think would lead to an ultimate sell off in stocks, regardless of the initial reaction.

I believe there is a 15% chance the Fed does nothing tomorrow, in which case stocks should sell off hard and the dollar should rally sharply against all of the major currencies currently sitting at or near their highs. In this case, gold should continue its short-term pullback that began yesterday.
~~~~~~

Lastly, I see a slight chance, 5% at most, that Bernanke et al cuts by 1/2%, indicating a near Fed panic in the economy. This is the toughest scenario to forecast, but my sense is that an immediate and sharp rally would ensue, only to be reversed minutes later or tomorrow.

Typical Fed day action calls for some early strength, a mild sell off and then a very slow move higher into the 2:15 PM announcement. Judging from overseas markets and early futures trading, that looks to be the case to begin the day.

It's All Fun and Games Until You Get Whacked in the Face!

~~~~~~

Regardless of what the Fed does, my opinion remains the same on the stock market; I believe we have one more decline ahead of us in November. That "should" lead to a very strong year-end rally right into January. While stocks seem in very good shape on the surface, it's those "things you never expect" that end up blind siding you.

Last weekend, I decided to knock off one of the items on my outdoor "To Do" list. As any good anal retentive homeowner does, I have my indoor and outdoor lists of things I can do myself over time and not spend money on hiring someone.

This past spring, cleaning, stripping and staining our deck was my top priority. I had a whole plan laid out and figured I could complete the project over two weekends, weather pending of course. You know the line about the best laid plans of mice and men, sometimes go awry? They wrote that for me! That little planned four day project ended up taking me until the end of the summer to complete, for a variety of unimportant reasons.

Anyway, on Saturday I decided it was the perfect time to trim these four hemlock trees we have on the back of the house to hide the foundation. They had grown too tall and many of the branches were now touching the cedar shingles, something I don't like.
~~~~~~

I saw stars as I fell backwards to the ground, not knowing what hit me. Covering my right eye, which was in excruciating pain, I looked up at my wife who was standing over me with the shears in her hand. With my son nearby, I refrained from using the words I wanted to.

What the heck happened? I asked her. At this point, I could not really see out of my eye. She was in a bit of shock as she explained that the shears opened up with one side hitting the ground. She accidentally stepped on the handle, forcing the heavy metal blades up from the ground to smash me in the face.

After the initial shock wore off and I iced the area, my sight was fine. The blades grazed the far right corner of my right eye hitting my lower socket bone and then my upper socket bone very hard. What kinda shook me up was that it was LITERALLY 2 millimeters from my eyeball and lord only knows what kind of damage that would have done!

It's four day later and except for some tenderness, I am fine. My wife felt totally awful and with the hormones of being pregnant, she was rather emotional. Because I like to poke fun, I had to tell her there much better ways to collect on my life insurance! My kids, of course, thought Daddy's boo boo was cool.

Similar to how I got whacked out of nowhere pruning the trees, I think the stock market has the same kind of risk in November. Should we get this decline I am forecasting, I think it will be short and sharp and out of the blue. Just like me, it will be a quick recovery. A decline that I will be buying with both hands!

Interesting Stock Market Tidbits

~~~~~~

Many of the emails I receive ask me the basis for the opinions I give. Since I enjoy educating clients and prospects, I always answer the best I can and include charts for more detail. Rather than wait for the usual emails, I thought I would share all of the tidbits currently front and center for me.

As you know, I expect one more decline in November. I base this on the horrid volume pattern since the August 16 bottom. Stocks have rallied on very light volume, while down days have come on much heavier volume. The opposite should be the case if the market was heading higher unabated.

Additionally, I am a big believer in sentiment. Going opposite the crowd at extremes has served me well during my career. Over the past few weeks, I have become increasingly worried about the level of bullishness among individuals who are usually wrong.

If you add those together and tie in some crummy intra day trading behavior and a market that is overbought in the short-term, there is a very good chance for a decline
~~~~~~

in November that would at least test the levels seen on October 22, roughly 3-4% lower from here.

It's no secret that Amazon, Apple, Google and RIMM have been major drivers of the stock market since the summer. You can add Bidu, EEM and Dry Ships to round out that list. I would keep a close eye on those for signs of a crack forming. They already lost Amazon, which I think will see ultimately see much lower prices, so one more prick in this bubble should hurt that group and the market as a whole.

Tempering what may appear as outright bearishness is some seasonal trends. The late October to early November period is one of, if not, the most positive times of the year. We rarely see any weakness.

Also, my colleague Mike just finished a study on stock market performance after Fed rate cuts. What amazed me was that if you separated the events into uptrending and downtrending markets, a very clear pattern emerges.

In the vast majority of cases, interest rate cuts while stocks were moving higher resulted in more price appreciation over the very short-term to as long as three months. My take on this is that any sell off that occurs today or tomorrow or next week should be bought for a trade. I believe the worst drawdown seen was only 2%.

That study really surprised me as I assumed there have been lots of cases where the market reacted by "selling the news". That's just not the case. If you want to see the details of this study, just let me know.

Before I conclude with what's becoming a very long edition, I want to update you on a very powerful trend. 2007 broke a fairly nasty streak of mini-crash like events during Octobers of years ending in "7". A few updates ago, I mentioned this trend, but thought the likelihood of it occurring this year was remote. Now it's done.

And lastly, the energy complex, crude oil in particular. This is and has been an historic run that we can tell our grandkids about. About two years ago, I targeted crude to $80, only to see it decline to $50 first. When it recovered to the $70s, it had the look of a commodity that would easily see $100, something I see before 2008 begins. And next year, after the first real correction concludes, we should, unfortunately, see even higher energy prices. As consumers, this is not good news.

Happy Halloween to everyone! Since we had kids four and half years ago, this has been one of our favorite holidays. There's nothing better than watching how excited the little ones get dressing up and then opening the candy. And of course, I get to binge as well!

To Your Financial Success,

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