November 4, 2007

10:22 PM EST (back to standard time!)

Inside this issue

Stocks Should Rally or Decline... It's that Simple!

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I want to start off by saying that my eye is essentially all healed. The small cut is gone and the tenderness is almost all gone. Now my kids can go back to head butting and attacking me again at will! I played the sympathy card long enough, but no one is buying it anymore.

This is one of those periods when the markets are crazy and more updates and hand holding are warranted, at least in my opinion. A few days ago, I described the three scenarios I thought could unfold with Bailout Ben and the Fed. Almost everyone was in the 25 basis point cut camp and agreed that the ensuing commentary would spark most of the reaction.

Thank you Ben for listening to the markets! Judging from the rather sanguine trading days leading up to the announcement, I was fairly confident we would see some violent reactions. And boy did we! Minutes before the news, the S&P 500 and Nasdaq began to sell off sharply, just like the previous Fed meeting.

As the rate cut hit the wires, we saw even more selling, driving the indexes from up almost 1% to down about 1/2% in just 20 minutes. And just when you thought the bears were coming out of hibernation, the bulls stepped back in with some fierce buying during the final 90 minutes of trading, driving the averages to their respective highs of the day.

I highlight the detailed movements to express just how volatile these events can be.
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But we weren't done. My own forecast was that no matter what happened immediately, after the 25 basis point cut I thought we would see a sell off. And boy did we get one on Thursday with the Dow down almost 400 points on heavy volume!

While my ego likes being stroked with the calls and emails telling me how right I was, the truth is that it wasn't a very difficult call to make. With almost everyone agreeing that 1/4% was the move and stocks rallying into that decision, it was a classic case of "buy the rumor... sell the news".

Now that the Fed is basically quiet until mid December and the majority of earnings season is over, we are back to the various economic reports, rumors surrounding the financial sector, reactions to the foreign markets and geopolitical news. In other words, a "quiet" time.

Although we did some aggressive buying mid morning on Friday, luckily at the lows, I am not yet convinced we have seen THE bottom for the rest of 2007. On the bullish side, Thursday saw 13 shares of down volume for every one share of up volume on the NYSE. Prior to 2000, that occured about once every few years or so and was very bullish over the next week, month and quarter.

During the bear market, the powers that be changed stock pricing to decimals from fractions, effectively reducing the number of stocks closing each day unchanged. This made it much easier during big moves to see up or down volume totally swamp one or the other.

Additionally, as I have written about several times before over the summer, the rules concerning shorting a stock were changed in July, eliminating what was called the "uptick rule". It is now permissible to sell short stocks at will and that also has had an exaggerated effect on up and down volume.

In 2007, days like Thursday have been seen 9 times!

Getting back to the bullish skews, we have both the 13:1 down/up volume seen on Thursday as well as October 19. That forecasts higher prices through year-end, on balance with a worst case drawdown (fancy word for paper loss) of about 5%.

Interestingly, the study I did on Fed rate cuts shows similar results. It calls for more strength ahead this year with drawdowns in the 2-3% range. So, you have to call me a bull through year-end with some minor caveats.

I usually don't like to spell out any plans here since they are bound to change with market conditions. But this is what I am thinking. Should stocks continue to rally for 1-2 weeks and get short-term overbought, I would think there would be an opportunity to make some money on the downside towards the end of November.

If, however, the recent lows do not hold, I fully expect the Dow to move towards 13,200 and the S&P 500 to see 1480, 2-3% lower from here. Both of these represent the 200 day moving averages, a popular technical level that often acts as a magnet when prices get close. Since the Nasdaq is much stronger, for now, I would think it sees about a 4% pullback from current levels.

To sum it up, if we rally now, I think we will see one more pullback towards month end and then a move higher into January. If we dip first, it should be 2-4% and I still believe that leads a year-end rally.

Housekeeping Items

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I want to spend a few minutes rehashing some comments I made last month since there was some confusion. To begin with, if you or your accountant are concerned over paying Uncle Sam short-term capital gains taxes in our more active strategies, we have an alternative offered through Jefferson National that defers taxes to a point in the future.

That means, you can invest in one of our investment programs, enjoy any potential gains and put off paying taxes, for now. Of course, there are no "free lunches", but we think this warrants a discussion so please contact me directly if you are interested.

The next topic is our recently launched High Yield Bond strategy. This is a new program for us and much like our recent foray into the developed and emerging markets, I have long expressed that I would only do it if I thought we had something unique and very powerful. I truly do.

And like the two international programs, we are waiving our management fees for your first quarter in the strategy for all new accounts opened in 2007.

Lastly, under the "housekeeping" subject, I want to give you a heads up that we are about to launch a wealth management division for clients with at least $500,000 in our investment strategies. For no additional fee on your part, we are going to offer tax, estate and insurance planning through one of our partners. Of course, there will be some minor limitations, but we feel these value added services will only enhance our relationship and help you as you look toward the golden years.

If the financial markets are quiet this week, you probably will not have to endure another update from me until next weekend or the following week. Have a great week!

Refer a Friend or Family Member

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Years ago, I began writing this newsletter actively because of a discussion I had with a client who also happened to be a golf friend. While he insisted he only looked at his account once a year or so and had no idea about the financial markets, he was remarkably "informed" when the market was in a state of tumult.

My client told me I should formalize my market comments on much more regular basis and send him and my other clients a letter or email. That conversation, along with some discussions with a few internet marketing folks led me to this.

And over the years, it has grown from just a few people reading to an enormous email list. I continue to publish because I truly enjoy writing it and it helps me to collect my thoughts. The feedback has been remarkable as well and people really seem to learn from it.

But in the end, this newsletter has been a fantastic way to communicate with my clients and prospects and it's become extremely profitable. While I don't know exactly what percent of my new business comes from my email list, I do know that many folks hear about me from a friend or meet me somewhere and ask me to stay in touch.

Staying "in touch" has been through this newsletter. So, a rather long winded way to ask you to refer friends or family, even if only to receive my writings at first.

Here's the link to give them:

www.investfortomorrow.com/newsletter.asp

Or please have them email me directly at paul@investfortomorrow.com.

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