February 9, 2009

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I Can Have My Cake...

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Since I am lucky enough to work only three miles from home, I have the "luxury" of popping in for lunch from time to time. Not only is my wife a phenomenal cook, but I get to see at least one of the three kids. Last week, my oldest son was home with 105 fever so I wanted to visit him every day.

As a parent you never get used to seeing your kids in that helpless and sad state. It hurts to watch them suffer. The woman who comes in to watch the kids when my wife works was over. And she decided to make my son a giant green cake, fit for 20 people, with matching icing in the shape of a dinosaur to cheer him up. Unfortunately, not only did he not have an appetite, but he really doesn't love cake.

But I sure do!

And over the course of the week, I polished off that entire cake for dessert. Dessert after breakfast. Dessert after lunch. Dessert after dinner. So to answer some folks' questions as to why I don't work from home much, it's because I would literally eat us out of house and home and double my body weight!

Without any good segue, my original intention was to write a "brief" update on the
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markets and then send my recession/depression issue later this week. However, as I sometimes do, I got carried away when I began to type and type and type.

To generally summarize my thoughts you are about to read:

Longer-term - October 10 remains the seminal day and the markets continue to build from the November 21 bottom towards a peak this quarter.

Intermediate-term - Bear market rallies rarely last more than three months, so it's especially important to see if this rally can make a new high after February 21. Index and sector leadership, along with volume remain constructive.

Short-term - The Nasdaq 100 is making new 2009 highs today, and sucking in late money. The other indices need to follow suit sooner rather than later. Stocks are getting a bit tired as the other indices run into overhead supply. Any further strength into the passing of the pork, I mean stimulus package should lead to a pull back.

The Goblins Of Dow 8000

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As I mentioned in the past few issues, not a whole lot has changed over the intermediate or longer-term. The markets saw a watershed day on October 10 and their price lows on November 21. Since then, as investors everywhere have run for bomb shelters, we've seen some very significant price appreciation across the board, albeit from much, much lower levels.

In 2009, the stock market saw its peak on January 6 and its low on the 20th. That's factual and indisputable. In between those levels, we've seem some rallies and pull backs, but no headway outside that range. If you've noticed, volatility has also declined substantially from the break neck pace of 2008.

Using the Dow, the "magical" 8000 level has repelled sellers every time. I say "magical" with lots of sarcasm because 8000 is just a number, like 8291 or 7308. But for some reason, big, round numbers have been accorded significant importance. Personally, I think it's a load of bunk.

Even better, I've heard from a few people who think there's a conspiracy going on for the professionals to defend the 8000 level on the Dow. I've been told the Fed is standing at 8000 buying everything up. Others have said that the insurance companies need the market to stay above 8000 or a wide spectrum of their products are under water, threatening their solvency. As with the "magic" of round numbers, I think it's all beyond ridiculous.

Just think about it, can you imagine an insurance company on the brink of disaster, worrying about how to pay their bills, but somehow having the financial wherewithal to commit billions of dollars to artificially support the stock market? Sure. And I'm George Washington!
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Funny though... we never hear about the conspirators putting a ceiling over stocks.

So today, we're fixed on the January high and low for confirmation of a larger move. Ideally, we want to see the various indices close above or below these levels first for a day, and then at the end of a week. It's not unusual to see widely watched levels act as magnets and then to see a dramatic reversal to the other side of the range as one side gets caught playing the breakout. Yet another reason, I continue to favor buying into weakness and selling into strength in most markets.

From a more intermediate-term perspective, bear market rallies seldom last more than three months. You can look at 2007 and then go further back to the 2000 - 2002 bear market. Until proven otherwise with the benefit of hindsight, we have to assume the bear market is alive until at such time when the indicators have confirmed a turn, which will absolutely occur at higher levels.

The important thing is that we have a major low in place on November 21 that is trying to morph into something else. One way to believe something has changed in a macro sense would be for stocks to make a higher peak after February 21 (three months), which would be above the January high.

As far as the rally goes, it's obvious, as I've mentioned before, that technology is playing an important leadership role. I've seldom seen any rallies survive without this group at the forefront. "Old" standbys, like Amazon, Google, Apple and RIMM are acting very constructively and should see MUCH higher prices this year, even if they pull back first.

Second, the order of leadership among the major indices is indicative of a "real" rally. We like to see the Nasdaq 100 and S&P 400 (mid caps) or Russell 2000 (small caps) outpace the S&P 500 and the Dow. That's exactly what's been going on since the November 2008 low and January 2009 low.

Besides index and sector leadership, it's a good sign that volume has started increasing on up days over down days. The internal nuts and bolts of the market have behaved very well and continue their process of hammering out a longer-term foundation. But remember, because of the depth and breadth of the bear market, it's going to take time to heal most of the wounds, and some won't heal for years and years and years.

Deflation/Inflation Cycle

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The 10 and 30 year treasury bonds have been decimated this year and are down more than 15% since their December 2008 peaks. (As price goes down in bonds, yields go up) While we would normally be concerned that long-term rates were heading up so quickly and dramatically, that's not the case when you are in a deflationary spiral, like
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today.

Too many people think the inflation question is black or white, inflation versus deflation. But they are DEAD WRONG. The cycle goes from inflation to disinflation to deflation to reflation and back to inflation. Optimistically, we're at the tail of end deflation and trying to move into reflation, something the Fed would do handsprings over! However, since deflation usually lasts a lot longer than anyone anticipates, let's not begin the celebration just yet!

It's going to take a lot more than just investors coming out of their bunkers (treasury bonds) to rid ourselves of deflation. The next thing to keep an eye on is the commodity market. Energy and food prices should begin to move higher in earnest when deflation ends. Right now, they are still pegged near their multi year lows.

Investor Sentiment All Screwed Up

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Turning to sentiment among investors, there are a few quick topics I want to discuss. First, I find it incredible how quickly people are dismissing the current rally in both stocks and bonds. What's worse, I hear people all the time describe the up moves as purely "short covering", not real buying, but that from folks who are exiting bearish strategies.

To begin with, short covering is present in every rally from any level. It's part of the dynamics of the market. And the vast majority of the time, the initial thrust off a low has a large short covering component to it. But that's really only confirmed in hindsight.

There are certain tendencies that indicate short covering, but unless you are an actual major broker/dealer who can see the various trades, you are simply making an educated guess. I heard some clown during an interview say that this is "definitely just short covering". Oh yeah? I'd like you to prove that. He didn't return my email.

Going a step further into individual investor land, I am simply amazed at the level of skepticism and disdain for the financial markets. Yes, I know that many people just saw 50% of their net worth vanish, but I cannot fathom the level of negativity I am seeing.

People talking about never investing again. Are you kidding me? I wonder if these are the same folks who quit their jobs in late 1999 and early 2000 because day trading was so easy, like owning a money printing press. I remember that Wall Street Journal article about the mechanic who took two hour lunches to day trade and supplement his income. This feels like the opposite to me.
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17 months ago, people could not invest their money fast enough. All they cared about was which vehicle was doing best so they could throw more money at it. I recall meeting with a man who laughed at me when I suggested diversifying his China dominated, long only, portfolio into other areas, assets and strategies. When I showed him a few of our strategies and performance, he skeptically asked why he would ever "settle" when China was going to take over the world. And as you can guess, that market promptly fell 70%+!

Fast forward to the past few months and now no one wants to put money to work in any market but the guaranteed one? People are worried about the markets falling apart now? Where ya been?

Folks, if you wouldn't invest after a 50% off sale, when would you? After prices go up 50%? I don't understand it. The markets were a good place to invest before it collapsed, but now it's no longer good? This is bassackwards behavior.

IF you are a real investor who has a certain time horizon and can tolerate some amount of risk, wouldn't you want to take that risk on now more than Dow 14,000? Isn't it time to put together several strategies that don't act alike?

The answer should be a resounding, YES! Even if the Dow trades back to 7000 first or it heads to 10,000. There are opportunities in every market, good and bad, across many different assets. It's about strategy diversification.

I can't tell you how many people I've spoken with this year who refuse to add money to their strategies out of fear. While the fear is certainly founded, it's an opposite emotion when it comes to investing. That spectrum of fear and greed. The best and most successful investors are those who can separate out emotion from their analysis, which isn't easy!

Too many prospects I've sat with lately keep using the word "hope". As I said last week, HOPE is NOT an investment strategy! And the notion that all anyone needs to do is buy American Funds mutual funds is absurd. I heard that three times this year. Sure, they are a quality company, although their overall returns were as bad as any other quality fund company in 2008. But it's still all based on an endless bull market, something that will never exist!

If you're an investor with cash who can tolerate a certain amount of risk, I don't know if there have been much better opportunities in the financial markets. And I don't mean to buy the Vanguard Index 500 fund to hold for 5 or 10 years (although there is even a case for that).

As I close what was supposed to have been a brief update, I can't say it strong enough. PLEASE hit reply or just pick up the phone and call me directly at 203.389.3553. If nothing else, let's discuss where you are now and where you want to be down the road. That exercise alone can help.

CNBC

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I am going to be on CNBC on February 11th between 8:00pm and 8:20pm.

As always, you can CLICK HERE to view past media appearances.

Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

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