July 27, 2010

10:14 PM EDT

Inside this issue

Ayn Rand Meet Vladimir Lenin

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FYI, I am going to be on CNBC's Squawk on the Street on August 3rd at 9:35am.

It's amazing. After writing this newsletter for well over a decade, certain trends develop. Predictable reactions from you. In the **previous issue**, I posted what I thought were another round of idiotic comments and stats, mostly regarding the third most powerful politician in the country, Nancy Pelosi, and her fellows on both sides of the aisle in Congress. And when my good friend, Chris Angle, replied and told me it was a great letter, I braced myself for backlash from the left. While I don't know Chris' political persuasion, it seems like he enjoys articles that many folks on the left do not.

Judging by the surveys I have conducted over the years, I think it's fair to say that my readers are generally moderate/centrist in their political views, maybe lean a little to the right. And I also know that I have a fair amount of folks on the left as well. So the "critical" comments about Pelosi and Congress brought the expected constructive criticism as well as the outright personal attacks.
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What's also become apparent over the years is that the left folks seem to take my comments more personally than equally critical words about the right. When I bashed Obama's stimulus program, something to this day I feel is a complete and utter waste of time and money if the intent was a long-term fix of the economy, I was bombarded with cheers and jeers. But the latter was much more vocal and venomous.

In May 2008, when Bush passed stimulus I, sending checks into many Americans mailboxes, I offered the same critical remarks. It was stupid at the time. It was even worse in hindsight. Some of you agreed with my remarks, while others did not. But I wasn't nearly as vilified then as I was after Obama took office and began his own series of blunders, half truths and misguided programs, following nicely in Dubya's footsteps.

As taxpaying citizens, it is our right, our job and our responsibility to question government and their actions. Government is dangerous enough by itself, but left unchecked, it leads to catastrophic situations. So if you don't agree with what I have to say (or even if you do), I invite you to reply and share your constructive criticism. Those of you who have almost always end up engaging in an email exchange.

It's okay to agree to disagree! Always in a respectful manner. Yet, if you still feel the need to call me names, like "100 times worse than Glen Beck and Rush Limbaugh", "you're what's wrong with this country", "liberal pig" and "left wing lunatic", I can take it. It would be interesting to introduce those of you who think I am a far left liberal with those who believe I am a hard right conservative.

Mr. Market Spoke... and We Listened

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In the previous issue, **Single Biggest Threat to our Economy and Markets**, I offered:

"Next week (week of July 19) should be very telling about the next 4-6 weeks. Stocks "should" attempt to gather themselves by mid week for another run higher, but that needs to be confirmed. It remains a positive sign that not only high quality corporate bonds are advancing, but junk bonds as well. That "usually" portends good things for stocks.

I am mildly bullish, dancing close to the door and waiting for the market to show me what it's got before committing more cash."

Mr. Market showed me a lot early in the week of July 19 and we were able to commit all remaining investable cash in our equity programs. From that point, it's been a near
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vertical and unprecedented run, culminating with three straight triple digit gains in the Dow.

To be clear, I do not believe the intermediate-term rally that began on July 1 is over. In the very short-term, stocks are due for a pause to refresh sooner than later and we began to anticipate that today with some profit taking. Until proven otherwise, the stock market should exceed the high it made in June in the next month before potentially running into more serious trouble as summer ends.

Market internals, like our own pulse and blood pressure, have been very constructive and sector leadership has been primarily from technology as all sub groups, semiconductors, software, telecom and networking have led the way. That's coupled with transportation, consumer staples and utilities, making a rather odd blend for longer-term sustainability.

On the flip side, although real estate (our largest position) continues to outperform, banks and other financials are not behaving well. Both healthcare and biotech are trying to form foundations for a rally, along with energy and agriculture. The market really needs to see the financials step up if this rally is going to last beyond summer, something I have questions for over a year.

On the fixed income side, safe haven treasuries continued to act well and should see another buying opportunity as the stock market builds towards an August peak. Both high yield (junk) and high quality (investment grade) bonds have been the real positive surprises over the past two months. I am keenly watching here for signs of a crack in the pavement as they usually lead stocks.

Financial Regulation... Good from Afar, Far from Good

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As you already know, I contribute to the New Haven Register's financial blog, **Fi$cally Fit**, (http://fiscallyfitnhr.blogspot.com/) every Friday. The latest piece is a must read from another website.

Financial Regulation... What It Means to You and America

(**http://fiscallyfitnhr.blogspot.com/2010/07/financial-regulationwhat-it-means-to.html**)

As expected, financial regulation recently was passed in Congress and President Obama has signed that into law. As I discussed in **Politicians Run Amuck**... Again, my overall view is that something is better than nothing, but this bill is far, far from perfect. Historically, sweeping reform often comes with unintended consequences and this bill, just like health care reform will have its fair share.
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To be clear, I have not read the almost 2000 page bill. My conclusions are drawn from a variety of research and commentary from both sides of the political aisle. I don't want to rehash most of what I already wrote about, but there will be a few repetitive comments. First and most importantly, shame on Congress for totally and unequivocally kicking the can down the road on Fannie Mae and Freddie Mac. That is appalling! Two of the main ingredients in the financial crisis are passed over? Is Congress kidding, scared of what they may find or helpless?

(NOTE: Several hours ago, the Obama administration released word that a special conference will be held on August 17 at Treasury to specifically address Fannie Mae and Freddie Mac. I fully applaud this effort and hope there will be bipartisan participation to solve this catastrophic mess that could end up costing the U.S. taxpayer almost one trillion dollars!)

President Obama pounded the table that "too big to fail" is over and we will NEVER again use taxpayer money to bailout failing institutions. Does anyone really believe that to be the case? You mean to tell me that if J.P. Morgan was on the brink of failure and needed a government backstop, the administration wouldn't step up? That's beyond naive to accept. We all know that Uncle Sam, whichever party is in control, would kick and scream but still come to the rescue.

I know what's in the bill, giving the Fed and FDIC new and extraordinary powers to orderly unwind a failing institution (something I totally favor), but I just don't buy it in times of crisis. There is no way, in my opinion, that anyone in government could have safely unwound Lehman Brothers to protect the system. And while a "bailout fund" may be created from this bill, who do you really think will end up paying for it? The banks may cut the checks, but that will certainly result from higher fees and charges to us!

The bill does address derivatives, by requiring banks to spin off certain groups under their control and move some trading to exchanges and clearing houses. Longer-term, I have to agree with this as it removes one element of potential financial Armageddon. But it does not come without cost. By spinning off these departments, banks will be required to capitalize (inject money) the new entities, further straining their own capital and reducing the amount of money to lend. That is called credit contraction, something we've been unsuccessfully fighting for three years. Less and tighter credit in the system will negatively impact economic growth in the short-term until the banks replenish their capital base.

The bill also limits banks from investing more than 3% of their capital in hedge funds and private equity. This provision was interesting as it suggests that somehow the hedge funds and private equity shops were a cause or accelerant in the crisis, something that is simply not true. I don't really care if this is law, but like most major changes, it should be phased in over a period of years. I do believe it will end up hurting bank earnings.

FDIC insurance was raised to $250,000, something that I applaud and makes perfect sense. That should help keep or increase customer deposits in banks (CDs, money markets, etc.), adding revenue and strengthening their base.

A new consumer protection agency/department is being created under the Fed as I understand it. Folks, we have enough governmental agencies, units and departments to last 100 lifetimes. We need another one like the Pacific Ocean needs more water!

This country will never fully recover from our economic malaise until government begins to shrink and the private sector starts expanding. Interestingly, although auto dealers originate 80% of auto loans, they were exempted from this bill. That's somewhat dubious from my seat!

I was surprised that few people talked about one of the root causes of the crisis, leverage. Over the years, the banking and mortgage industry have created all sorts of non conventional, fancy, outside the box products that few, if any, really understood or knew how to use. If Congress really wanted to prevent another housing bubble and fix the current problem for the long-term, they should have considered requiring 20% down on all mortgages. Yes, I know that many people could not afford it, but that's exactly what used to be the norm before we decided that owning a house was part of our right of passage in this country.

In the short-term, it would further depress an already depressed sector, but it would also begin to create a very long-term, stable and constructive housing market for decades to come. Like addressing Fannie and Freddie, this would not be politically popular (so probably very smart!) and therefore not interest the vast majority of politicians only interested in reelection, pandering to the media and special interest.

As I said, overall, the bill is something and it's probably better than nothing, but by no means the final answer. I believe it is deflationary in the short-term and will lead to further credit contraction and harm to the economy. Financial institutions are creative, cagey and shrewd, employing some of the smartest minds on earth. Longer-term, they will likely adapt and adjust, find loopholes to make up for lost profits. I just hope that we don't drive too much business to other shores.

Upcoming TV Appearances

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CNBC's Worldwide Exchange - July 27 at 5:30am

CNBC's Squawk on the Street - August 3rd at 9:35am

CNBC's The Call - August 9th at 11:10am

CNBC's Worldwide Exchange - August 26 at 5:30am

CNBC's Worldwide Exchange - September 28 at 5:30am

You can view most of the past segments by clicking below.

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)
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Investment Quotes/Adages To Live By

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1931
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"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher via Casey Research

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

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.

Sign Up Here

You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.
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