September 1, 2011

10:11 PM EDT

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Inside this issue

What a Week It was and is...

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Let me start by wishing you a very enjoyable and safe Labor Day weekend. For many in the country, it is the final weekend of summer with the beautiful days and nights of fall not too far off.

Before we get into this issue, I would appreciate 30 seconds of your time to answer two simple yes/no questions. As always, I will report back on the answers. Please Click Here

One of the great myths in investing is that of the "summer doldrums". As the nonsense goes, nothing really happens during July and August as traders and investors are all away vacationing in the Hamptons. While that may be true every now and then, you could probably say that about any period during the year!
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August 2011 was certainly not quiet on the news front or in the markets. Last week alone, the news was enough to make you dizzy. The east coast experienced a 5.8 magnitude earthquake which was considered serious at the time. But Hurricane Irene made us all forget the quake and deal with her wrath. Incredibly, even though our office was in a low lying area that was asked to evacuate, we opened as usual on Monday morning with absolutely no damage, power outage or technological difficulty. Better to be lucky than good!

Getting back to last week, Steve Jobs sadly resigned from Apple due to ongoing health concerns. Deven Sharma, CEO of Standard & Poor's, also curiously resigned. I am sure the conspiracy theorists are all amped up over this one! Warren Buffet made a surprising investment in Bank of America with terms that only he could demand. I often get questions about buying BofA stock and my answer hasn't changed in at least five years. I can look at anything for a trade, but this bank remains in my doghouse long-term as I do not believe it can exist in its current form. At some point the rubber will meet the road and they will have to make some difficult decisions regarding their purchase of Countrywide, capital and properly marking their assets. I am anything but an expert on banking stocks, but from my experience, it's usually best to stick with the strong ones.

We also heard from Ben Bernanke last week at the annual economics symposium at Jackson Hole, Wyoming. I was fascinated by his speech and the markets' reaction. From my seat, Ben essentially said that the Fed has done its job and it's time for Washington to get off its rear end and strike a bipartisan compromise on fiscal policy to help the economy. He was very clear that too much austerity would not be a good thing for our economy in the short-term, but long-term deficit reduction measures must be enacted. It was like he has been reading Street$marts and borrowed my suggestions. You're welcome Dr. Bernanke!

Getting back to Irene, it has been a very difficult time in the northeast and progress has been slow. Before the storm, my wife and I moved the kids downstairs to sleep in the middle of the house next to a load bearing wall since we have so many trees, some dead, close to the house. We joined them on the floor in the next room and I wrongly figured we would wake up on Sunday morning with power and then it would go out when the storm really hit. Thankfully, we filled the bathtubs beforehand and stocked up on flashlights and batteries.

Stupidly, I drove around during the storm on Sunday surveying our town and it looked like a nuclear bomb hit with so many trees and power lines down. It's almost five days later and the main roads were just cleared. Some of the smaller, side roads remain partially or totally blocked and many of our friends still do not have power with the possibility of not getting it restored until next week.

I hope that most of you have your power back on. Ours at the house came on last night after being out since Saturday night. I have never been so happy to see the dirty lights on the porch glowing as I was last night driving in. But we had it easy; my in laws welcomed the family at their house in Fairfield and I felt like I was staying at a five star resort with food on the table when I woke up, fresh towels, maid service and awesome dinners when I got home from work. I did bring wine, though!

Longtime readers know how much my family loves Vermont and the damage and destruction up there is beyond heartbreaking. Littered with small towns on rivers from the old logging days, the state has to have more old little bridges than any other. Sadly, many of them were washed away, stranding entire towns. I saw the National Guard airlifting food, water and medicine as they scrambled to assemble temporary, makeshift bridges and roads. Where we frequent in southwestern Vermont, some of the lower lying towns are essentially gone. Flood waters have either destroyed or or made inhabitable much of the commercial areas. Even the main base lodge at elevated Killington collapsed.

As we have seen with other natural disasters in this country, this too shall pass. It will take some time, but slowly there will be a recovery and some sense of normalcy will return. Just like I would not bet against the American economy over the long-term, I wouldn't envision failure for New Englanders. I have said this many times before and it bears repeating. During difficult, challenging and stressful times, we often find out who our true friends and partners are and who is just pretending.

FYI, I will be on CNBC's The Call on Friday at 11:05am or so.

More Post Crash Action

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In the previous issue, 24 Years of Crashes, I reviewed a boatload of charts to help depict the aftermath of crash and mini crash type action in the stock market since 1987. The majority of the time, we saw the actual low of the crash day revisited at least once, if not several times before a more meaningful and longer lasting rally began.

As I explained in the last issue, I believe the action in the stock market in early August was that of a mini crash, similar to the crash of 1987, 1998 and early 2008. Below I have included those charts again.
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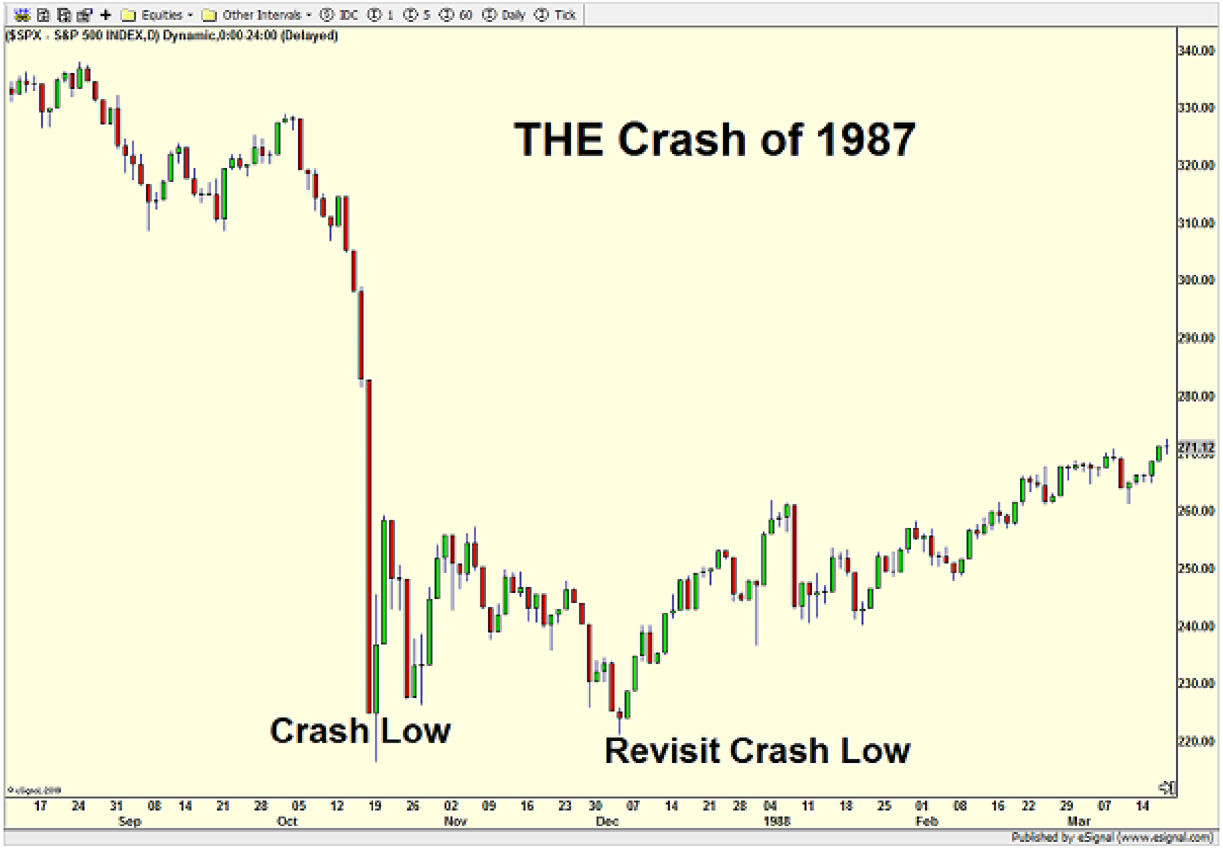
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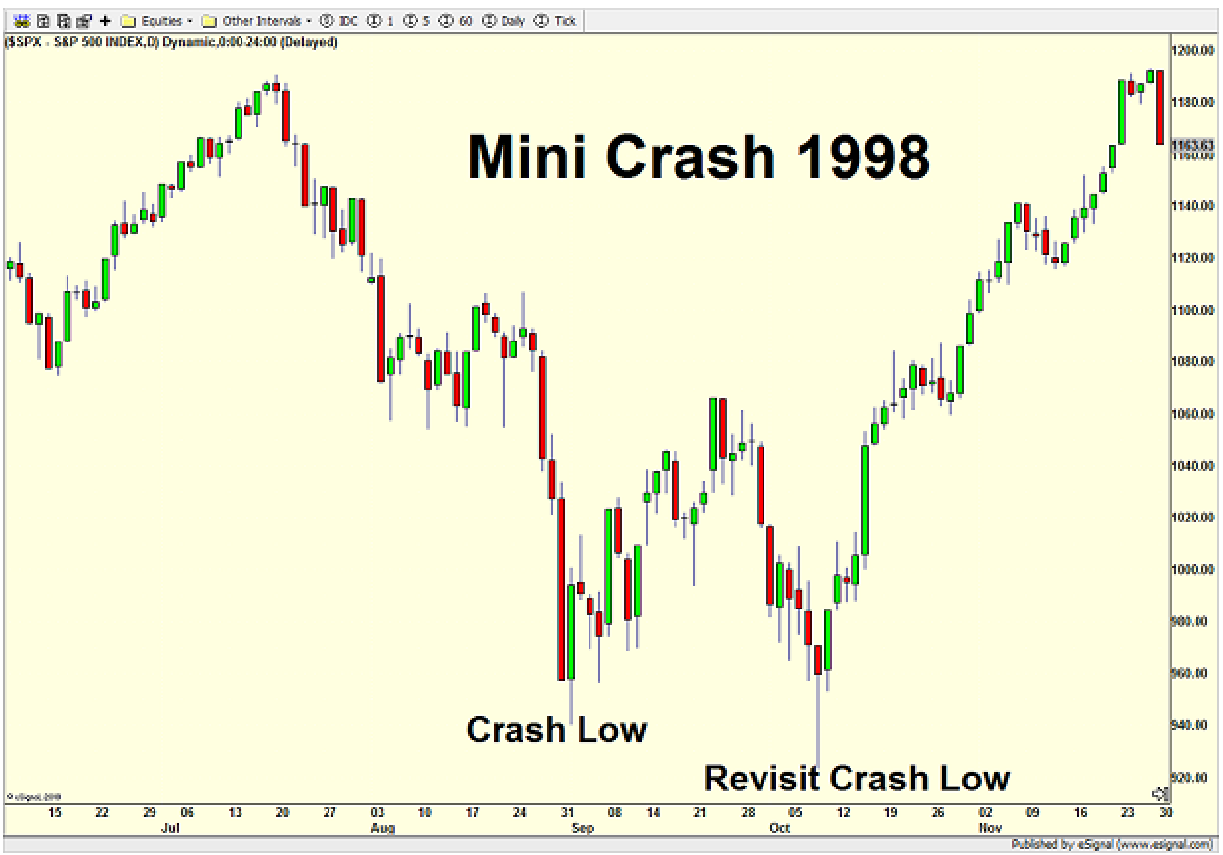
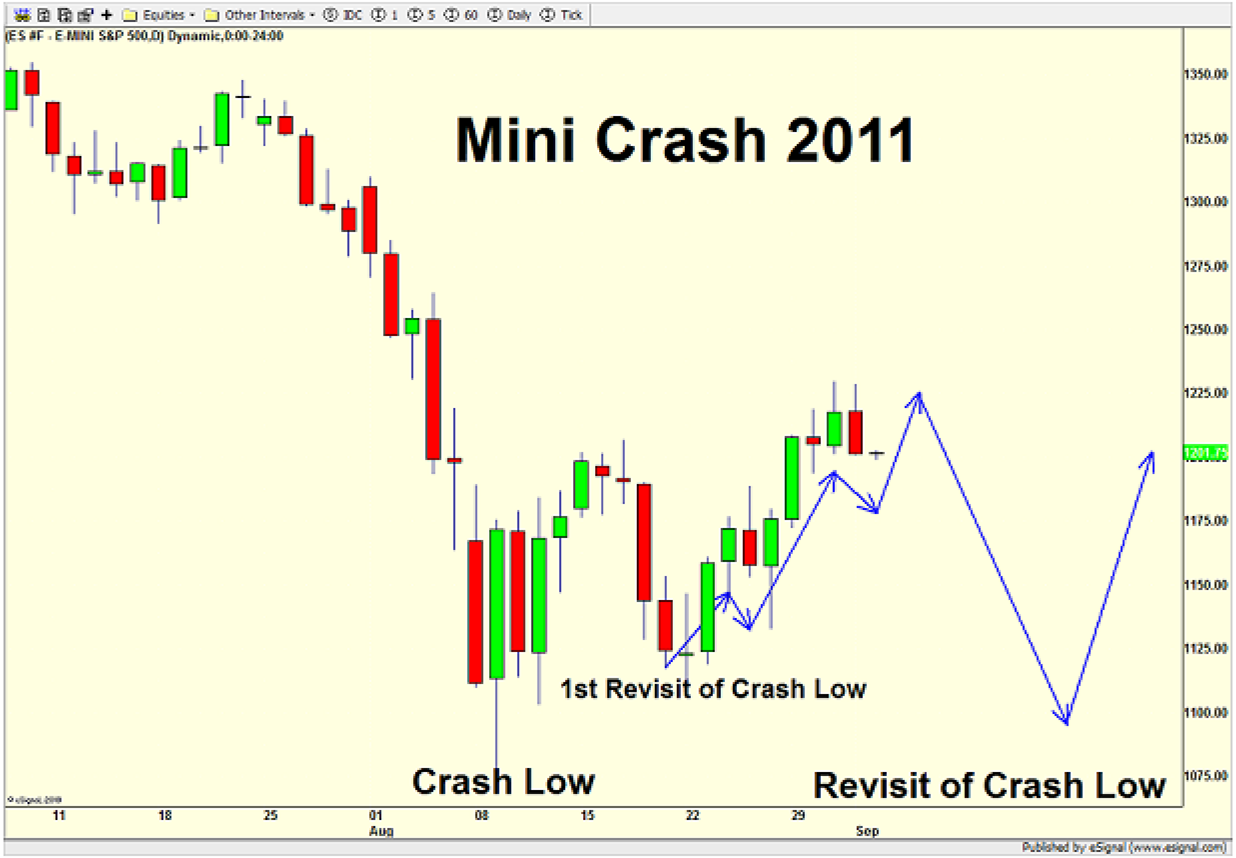
THE Crash of 1987
Crash Low
Revisit Crash Low
Published by eSignal (www.esignal.com)


($SPX - S&P 500 INDEX,D) Dynamic,0:00-24:00 (Delayed)
Mini Crash 1998
Crash Low
Revisit Crash Low
Published by eSignal (www.esignal.com)

Although the three events are not exactly identical, nothing is in the markets, they happen to rhyme very nicely with a crash, rally and revisit in the big picture. Sometimes we saw immediate revisits of the crash low. The few times over the past 40 years where we saw crashes and no successful revisits, the stock market had entered a bear market.

Below is an updated chart of the first scenario I offered. So far, the market seems to be following that script and ever so slowly trying to return to "normal". But just when we start to fully get comfortable, I am sure the market will throw us a curve ball, possibly as early as Friday morning with the employment report at 8:30am.

The few bulls that are left point to the crash low and first revisit as a two lows from where the foundation can be built for a resumption of the bull market. Given the height of the first rally from 1100 to 1200, that would predict another 100 S&P points or at least 1300 as the ultimate target. I will spell that out on a chart next week.



Another possible path for stocks would be more strength into mid September and not as violent a decline into October. That would be followed by a very strong rally into January towards or through the 2011 highs. The very, very bearish case holds that the decline from late July to early August will be repeated once the current bounce ends, taking the S&P 500 well below the August lows and towards 1000. One scenario I have not discussed is that the market remains in a trading range between 1100 and 1250 for several months. While I don't see this as a likely scenario at this point, I will continue to watch for signs of something else happening.

In the short-term, stocks have looked tired for two days and we saw the results of that with this afternoon's orderly sell off. Unless the S&P 500 goes right back above this week's peak, I think we may have a few more days of digestion before the bulls try to mount another charge.

Please don't hesitate to hit REPLY or call me directly in the office to discuss any of this in more detail.

Aftermath of the Debt Ceiling Compromise

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Joel M. Sachs, CPA, MST, principal at Konowitz, Kahn & company, P.C., provides a perspective on the recent heated deficit discussions in Washington and what the newly passed bill means to tax payers.
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On August 2, President Obama signed the Budget Control Act of 2011 after the bill passed the House by a vote of 269 to 161 and the Senate by a vote of 74 to 26. The Act accomplished several goals, chief among them a $1 trillion cut from the federal budget deficit and the formation of a bipartisan Joint Select Committee (JSC) to find an additional $1.5 trillion in deficit reduction over the period of fiscal years 2012 to 2021. The JSC is charged with the task of drafting additional deficit reduction legislation in time to be voted on by Congress by the end of this year.

The Administration interprets the JSC's directive to mean that everything is on the table, including tax reform. After announcing the agreement on July 31, President Obama said "The ultimate solution to our deficit problem must be balanced. We have to ask the wealthiest Americans and the biggest corporations to pay their fair share by giving up tax breaks and special deductions."

The JSC on Deficit Reduction will consist of two co-chairs and four others. Senate Majority Leader Harry Reid, D-Nev., appointed to the JSC on Deficit Reduction Senators Patty Murray, D-Wash., Max Baucus, D-Mont., and John Kerry, D-Mass. Murray will serve as one co-chair. House Speaker John Boehner, R-Ohio, appointed Jeb Hensarling, R-TX as chair, Dave Camp, R-Michigan and Fred Upton, R-Michigan. Senate Minority Leader Mitch McConnell, R- KY, selected John Kyl, R-AZ, Pat Toomey, R-PA and Rob Portman, R-Ohio.

In other words, the President is expected to push the committee to include tax provisions in its legislative language. In turn, the Republicans are expected to resist those attempts as they look for an across the board reduction of tax rates as a way to grow the economy and thereby increase revenues.

What tax provisions are under consideration? Many of the proposals effect individual deductions that were once considered hallowed only a few years ago but are now being seriously considered due to the deficit.

The following proposals are being considered:

· Replacing the current individual income tax brackets with three new brackets ranging from 8-12 percent, 14-22 percent and 23-29 percent
· Abolishing the Alternative Minimum Tax, it would be permanently repealed.
· Limiting Itemized deductions.
· Reducing the benefits of itemized deductions for upper-income taxpayers by converting the deductions to a 12% tax credit.
· Reducing the benefit of the mortgage interest deduction by limiting the interest write-off to $500,000 of acquisition debt.
· Eliminating the deduction for home equity loan interest and interest on second homes.

· Reducing the favored treatment of long-term capital gains and domestic dividends.
· Reducing the deduction for contributions to retirement plans such as 401(k)s, IRAs, Keoghs and other profit sharing plans
· Eliminating accelerated depreciation for business taxpayers
· Reducing or eliminating the Research and Development tax credit

It is not expected that all of these provisions will be passed. However, Congress and the President surely see the need for drastic measures in ensuring that the deficit be reduced.

For more information about tax issues for you and/or your business, contact Konowitz, Kahn & Company, P.C., at 203-239-6888 to speak with a tax specialist. Visit the firm on the web at www.konowitzkahn.com.

Upcoming Appearances

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CNBC's The Call - September 2 at 11:05am

World Cup of Trading ETFs - November 15 - 16, West Palm Beach FL

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

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)

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

"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 continue 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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