September 23, 2011

1:52 PM EDT

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Inside this issue

That was Quick

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It was nice to get called for a last minute CNBC segment yesterday discussing the huge two day decline and Fed's action. More on that in the next two articles. We have received a fair number of media quotes lately and you can view the articles here, including one remembering exactly what I did on 9-11. Just keep scrolling down and they will be listed in chronological order.

While I really did enjoy and applaud President Obama's speech a few weeks ago as well as the republicans lack of partisan response, the honeymoon is over and we are back to politics as usual. Obama recently unveiled over a trillion dollars in tax increases on "millionaires and billionaires" to pay for his new plan and I think everyone knows that's dead on arrival in the House.
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We also learned that the proposal is essentially $2 of cuts for every $1 in tax increases. To me, we are getting somewhere! As I have mentioned over and over, Michael Boskin who worked under Bush I did extensive research to conclude that the ratio of $1 in tax increases for every $4 in spending cuts made the most sense for the economy. It was not a cure all and certainly not painless, but did provide an acceptable bipartisan solution, one that I would certainly support as a moderate republican.

What bothers me is that for the life of me, I cannot understand how the republican leadership will not even negotiate any revenue increases at all. I know they are focused on preventing President Obama from being reelected, but a "throw all the bums out" mentality would certainly hurt the House as well. I think it is 100% asinine for campaigning politicians to take an oath or sign a pledge never to do something. In life, we never know what circumstances may dictate what response. Signing a pledge never, ever, ever to raise tax revenue no matter what makes no sense to me. There are just too many factors that change over time.

I certainly do not want my taxes to go up. I think I pay too much as is. As I have mentioned before, we need comprehensive tax reform. All parties give a little to get a little. Maybe the retirement age is raised to 70 over time in exchange for moving the cap on social security taxes to $200,000. Maybe the mortgage interest deduction gets phased out above a certain income threshold and agriculture and energy subsidies go away in return for cutting the corporate tax rate and bringing back trillions of dollars offshore from US companies to invest and hire. There are plenty of ideas floating from folks a whole lot smarter than me, but unless both sides stop digging their heels in on every issue, there is little hope to accomplish anything meaningful.

I am going to close this article and my rant with a non political and non market article I found online concerning the safety of your data and what to do.

[Defend Your Data After a Breach]

Post Crash Behavior Still On Track

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The charts below should look familiar as I have included them since mid August, with good reason. The theme continues to be post crash stock market behavior after the early August mini crash. Although there have been many mini crashes since 1987, I still believe that the current market most closely resembles that of October to December 1987, August to October 1998 and January to March 2008.

In each case, there was some type of waterfall decline, culminating in the
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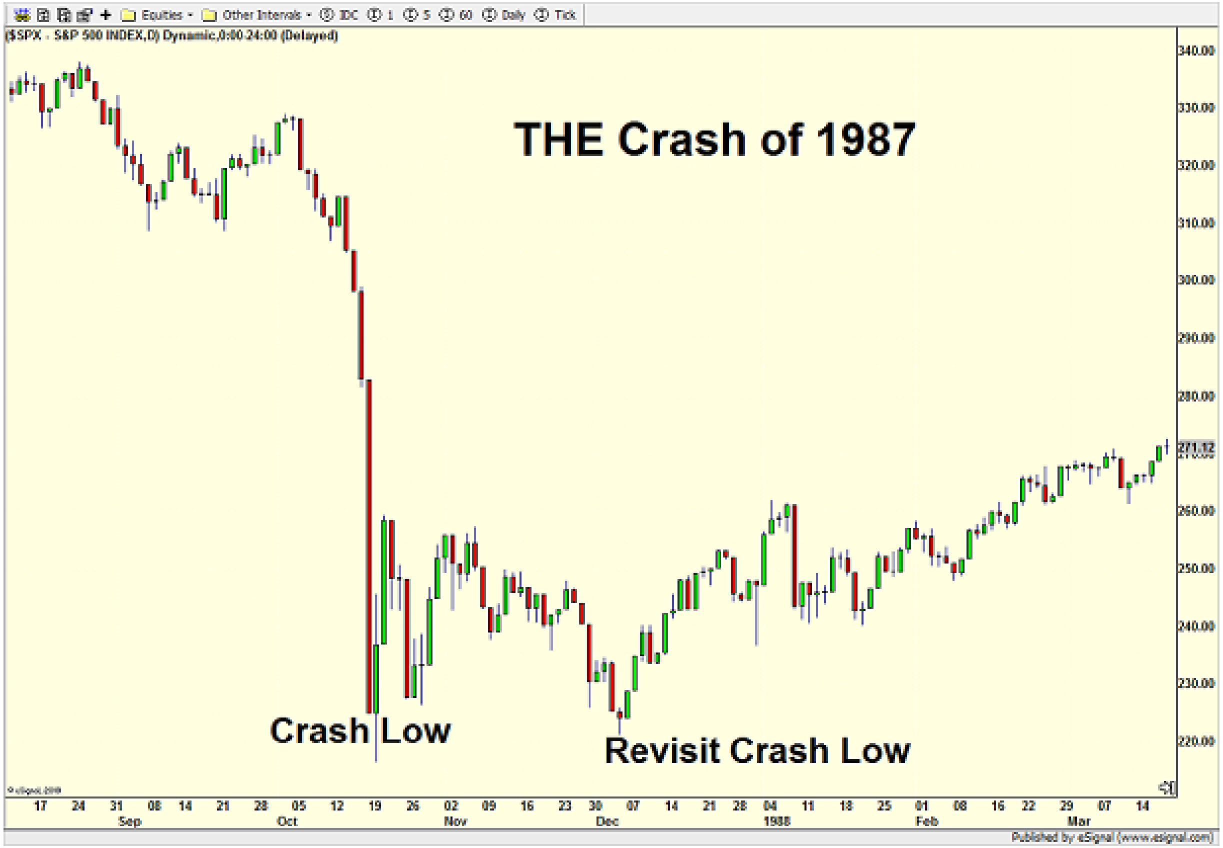
"crash low", which was on record volume. From there in all three cases, the market embarked on a multi week rally before rolling over again to revisit the crash low price level. Best case, prices closed at just a new low, but we usually saw a quick "woosh" lower that one day when traders and investors threw in the towel and panic sold, also called capitulation, when prices did not stop at the previous crash low.

The good news is that once that final "woosh" lower was seen, prices bounced back that same day to close the day nowhere near the low. And then the bulls came roaring back to life and the rally began.

So far, the market has been following the typical post crash behavior and that's the way to lean until proven otherwise. Maybe this bottom will be a bit more complex and diffuse to confound more people? Although we've just seen two straight big down days, there should be more weakness over the coming few weeks.

In the very short-term, stocks are due for a snap back rally as early as today. And that rally, although brief, could be very sharp and possibly retrace Thursday's decline. If stocks can't rally today and close poorly, the market will likely see a decline below the August crash low early next week before the bulls come back to fight.

After stock market corrections, market leadership often changes. Since the market's secondary low on August 19, technology, especially semiconductors, has traded like gangbusters and that looks to be one of the leaders for the anticipated rally next quarter. I would also expect the retailers to behave well. Initially, what went down the most usually bounces the most before the real winners emerge and take over.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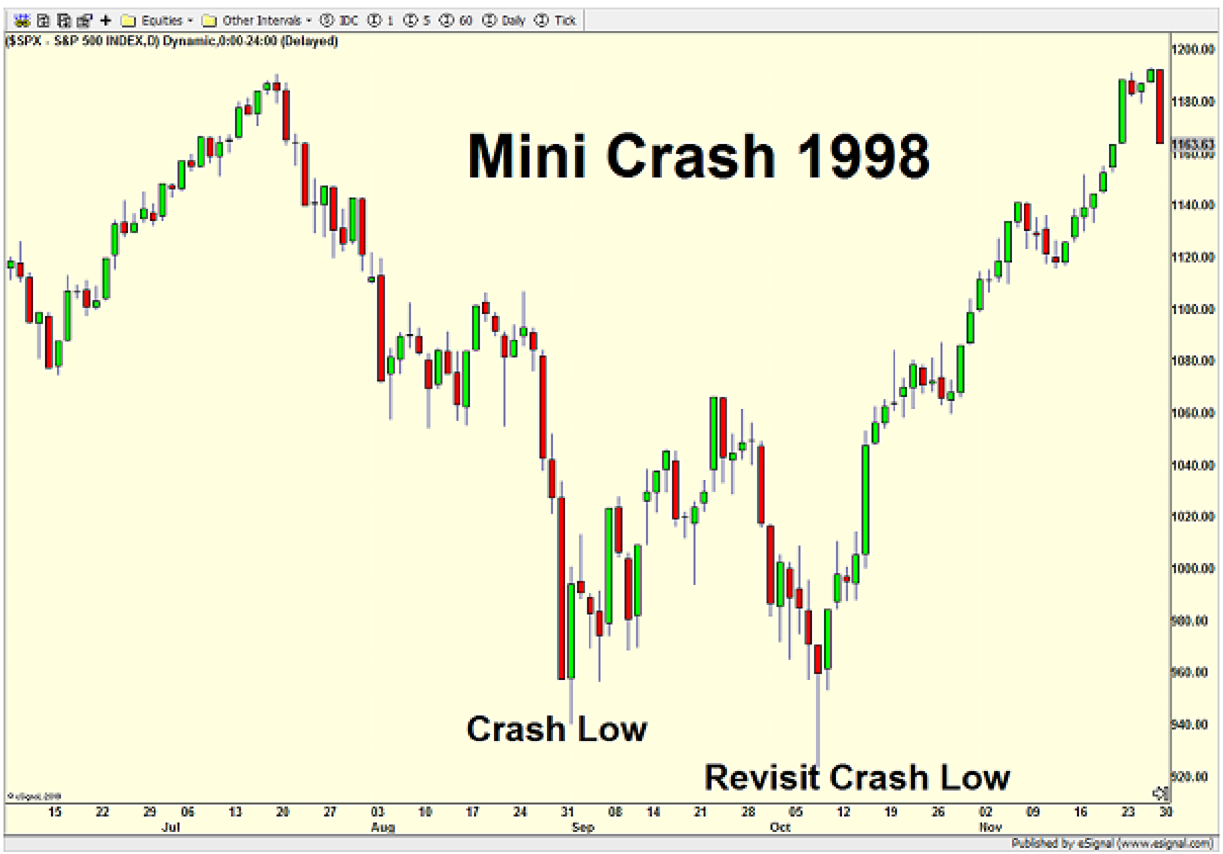
THE Crash of 1987
Crash Low
Revisit Crash Low
Published by eSignal (www.esignal.com)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Mini Crash 1998
Crash Low
Revisit Crash Low
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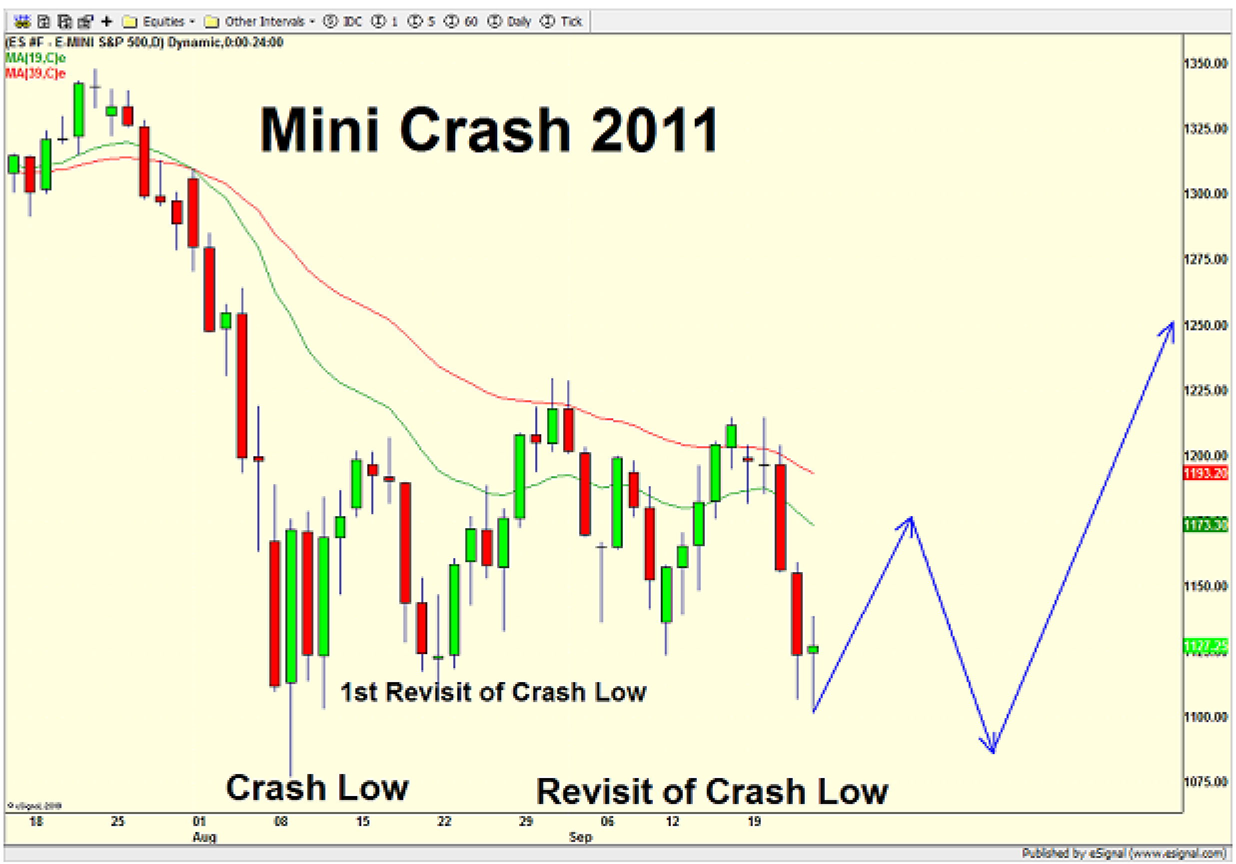

If any of this does not make sense, please don't hesitate to hit REPLY or call me directly in the office to discuss.

What the Heck was the Fed Thinking?!?!

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On the surface it seems like the financial markets have been in panic mode for a long while. The news flow is about as dark as it has been since 2008, but this is definitely not 2008 all over again. Interbank lending is not frozen like it was three years ago and the global central banks are not sitting on their hands like they did three years ago. Don't get me wrong, things ain't so great, but the financial system is not on the verge of total collapse. The Fed, ECB, BoJ (Japan), BoE (England) and SNB (Switzerland) are acting in concert as lenders and liquidity deliverers of last resort.

The day to day volatility remains extremely elevated. I have been warning about expecting almost daily triple digit moves, up and down, into fall and that's still the plan. I think the market is more than half way through this period, but it's not over yet.

The news from Greece is literally all over the map. One day, there is progress on a new deal, the next day they are defaulting. What I find so fascinating is just how polarized the views are. I have heard from a dozen experts and the two sides are about as far apart as possible on an outcome.

One group is adamant that Greece not default or leave the Euro. The other side is firm in their belief that the only solution for Greece is to default, leave the Euro, start printing Drachmas and severely devalue their currency. There were even rumors last week about the government secretly cranking up the printing presses in anticipation. If that's so, how is it secretive? Given that the country is already in a modern day depression that's likely to get worse, staying the course is not an option.

Of course, I haven't even mentioned a solution for Italy, which is systemically, much more important than Greece. But that's what market bottoms are usually made of, major news events. We saw it with Bear Sterns in March 2008, Worldcom and Enron in 2002, 9-11 in 2001, Long Term Capital in 1998 and the Orange County municipal default in 1994. Not all events led to bull markets, but rallies were seen in each case that were very tradable.

We also heard from Ben Bernanke and the Fed this week. I commented about it on Twitter and Facebook so if you are interested in short-term comments, please scroll to the top and click on the icons for Twitter and Facebook to sign up. I didn't think what the Fed did was as important as the market's reaction and boy did the action speak volumes!

As expected by everyone, the Fed enacted Operation Twist, which shifted the maturity of its treasury holdings from very short-term to more intermediate and long-term in an effort to further reduce mortgage rates.
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Long time readers know that while Ben Bernanke has made his fair of mistakes, I have been a fan of the chairman. And I still am, but their statement and action this week lead me to scratch my head.

In my humble opinion, interest rates and liquidity are not the problem. "Twisting" their holdings is only going to slightly increase shorter-term rates and hopefully bring down longer-term rates, in effect flattening the yield curve which hurts bank earnings and is less stimulative to the economy. It leaves me kind of confused.

The strong statement about significant downside risks to the economy really concerns me. Is the Fed finally catching up to the market? Or have they just uncovered a new hornets nest? In either case, Operation Twist is like using a garden hose to put out a forest fire, which is what I was trying to say yesterday on CNBC in my botched analogy.

And what's with Plosser, Fisher and Kocherlakota dissenting again? I understand they don't see the need for 0% short-term interest rates through 2013, but that can be changed at any meeting. That Charles Plosser's economics models don't see downside risk is scary! Don't forget, it was Plosser and Fisher who dissented in 2007 and early 2008 with lowering rates when the credit crisis was unfolding and credit was freezing. They probably belong with the ECB more than the Fed for worrying about inflation when deflation is consuming the world.

Getting back to the Fed, if they are truly that worried about the economy, they should have come out with shock and awe, not a pop gun! The lack of a big response makes me think they are running out of outside the boxes bullets, which pretty much supports my long-term thinking that only time can cure what ails us in this deleveraging process. Japan made the cataclysmic mistake of sticking their heads in the sand for a decade before taking any action. I give our Fed enormous credit for the unprecedented actions they took in 2008, but at some point, you have to let the markets finish the job. Given how long this issue is already, I won't go into the fiscal side from Washington. That will only aggravate us both heading into the weekend!

Upcoming Appearances

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CNBC's Squawk Box - October 3 at 6:10am

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

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