June 5, 2012

2:18 PM EST

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Inside this issue

Never Enough Job Creation

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As most of you know, I tend to write a lot, both in this newsletter and elsewhere. If you would like to read more in between issues, you should bookmark our blog at www.investfortomorrowblog.com, follow me on Facebook or Twitter which you can click on above, or join our Vestorly page (email me if you have not received an invite).

Also as most of you know, I enjoy sharing my thoughts in the media and we archive those at http://www.investfortomorrow.com/InMedia.asp. When I remember, I will sometimes share a particularly interesting segment in this part of the newsletter. Last week, I participated on an interesting, but unusual segment on CNBC's Closing Bell discussing **Wall Street Ethics versus Business** (http://video.cnbc.com/gallery/?video=3000092535&play=1).

Before I get into some controversial comments, I want to share a story from home. A few weeks ago, I got a haircut, which I tend to do from time to
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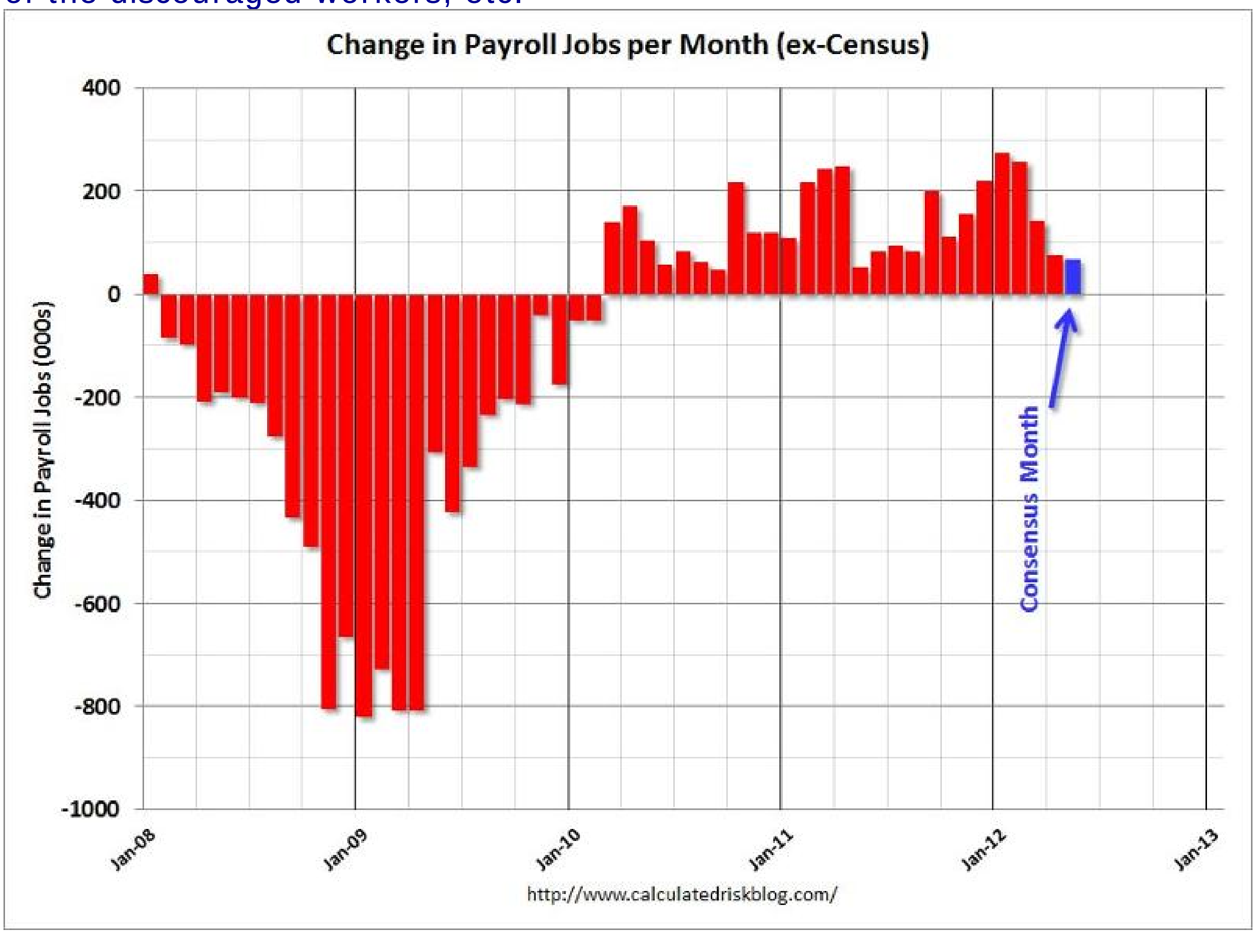
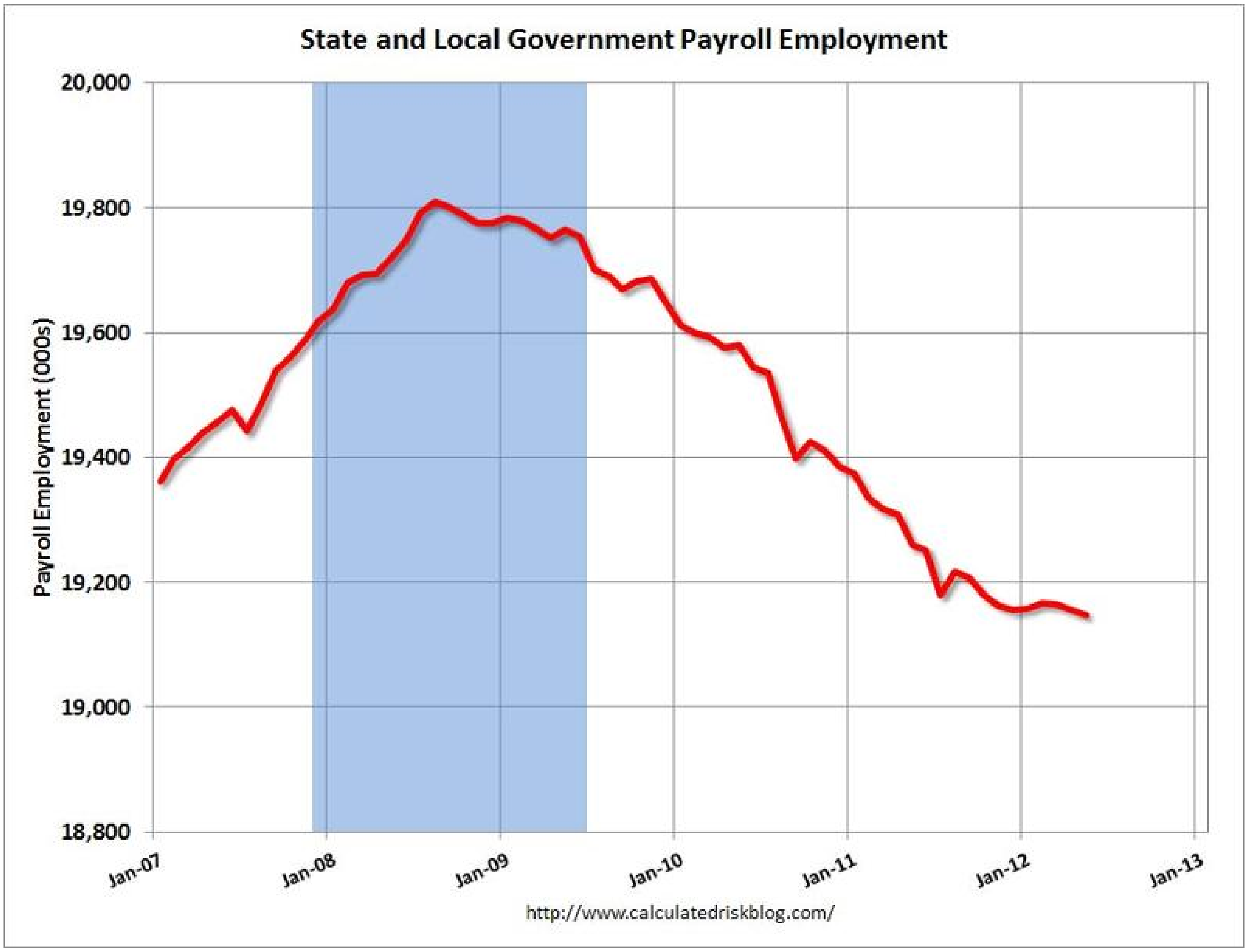
time. And since I was in a hurry, I left with my hair a bit wet and uncombed to rush home, shower and get to one of the kids' game. I turned into the driveway and was stopped by my four year old. He turned his head so his ear fell towards his shoulder. He scrunched up his little nose, squinted his eyes and dropped his eyebrows. I said, "yes?". He looked at me and said, "Daddy, what happened to your hair?", to which I replied, "what do you mean?". My son finished me off with, "It does not look so very good. You should get your money back."

As the "lull" in political campaign season continues, last Friday's employment report sparked strong remarks from both sides. As you can see in blue from the excellent chart below courtesy of the folks at Calculated Risk, although roughly 69,000 jobs were created, it continues the four month string of weaker jobs growth. Remember, we need to create about 150,0000 jobs per month just to keep up with the population. And May saw an awful lot of folks (642,000) come back into the work force to be counted as unemployed. As most of you know, the 8.2% unemployment rate is almost 15% when you include the underemployed and probably approaching 20% when you add all of the discouraged workers, etc.



As I discussed a few weeks ago, a very powerful trend of lower state and local government payrolls continues today as you can see from the chart below. Short-term, this remains a drag on the economy, but over the intermediate-term, state and local municipalities are getting their own fiscal houses in order and that will eventually be a big benefit, especially when the private sector begins to really add jobs down the road, which I believe they will. Stay tuned for a special report entitled Over the Horizon where I will offer some very long-term, outside the box thinking on what lies ahead the rest of this decade.



Getting back to the employment report, when the economy was adding 200,000+ jobs per month earlier this year, it was very tough for President Obama's critics to make a convincing argument for change. But now, with the employment picture weakening, Mitt Romney seemingly has all of the answers. And I look forward to hearing details of just what that entails rather than the usual political bullet points and sound bites.

What bothered me last Friday was how the Obama administration changed their message of blame on a dime. When job growth was steadily climbing late last year and early this year, the president took all of the credit, citing his policies. But now, with back to back poor showings, suddenly it's Congress' fault for all of this. You can't have it both ways.

I am the last one to defend Congress. And I do blame them for lack of compromise, lack of bi-partisanship and a total lack of putting the country's interests ahead of their own. But they are no more to blame for the weakening employment picture now than they were to be credited for the better picture several months ago.

As I think about it, perhaps we need a new party called the Grown Up party that's made up of folks who sit just to the right or left of center, never make idiotic pledges just to attain office and never use phrases like "take it or leave" or "it's the other party's fault". Yes, it's long overdue for this party

and these people to step up. Naive? Probably.
I'll close with another head shaker. Is Mayor Bloomberg serious about limiting the size of sugary drinks that can be purchased? Has he lost his mind? What's next, forcing you to eat three servings of green, leafy vegetables per day, consume at least 8 glasses of water and get eight hours of sleep? While all of this seems perfectly logical in a vacuum, we still do live in a quasi democracy, even though as a society, we don't make very good health decisions. Why not outlaw alcohol and cigarettes? Mandate at least an hour of cardio three times per week? Since obesity is an enormous drain on the healthcare system, why don't we just make it illegal?

Bulls & Bears in Tug-o-War

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In last week's issue, **The Facebook Fiasco... A Guide of How NOT to IPO**, I updated two possible scenarios for the stock market as you can see below. The fact that the stock market couldn't rally for more than a day or so exposed just how weak it really was, leading to last Friday's rout by the bears. That also unleashed the darker blue scenario, much faster than I thought.

Adding insult to the bulls' injury is the fact that Friday and today (Monday) were supposed to be seasonally positive days for stocks. That's another cause for concern. But as you can see below, the darker blue scenario calls for a rally to begin sooner than later.
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On the positive side for the bulls, the major indices have now declined at least 10%, which often brings in some buyers. The market has corrected for roughly 9 weeks, which is about the average since the bull market began in 2009. Sentiment has swung from fairly optimistic to overly pessimistic this quarter. And this last decline has not been confirmed by a host of technical indicators.

On the flip side, momentum still sides with the bears and our most prominent market models have yet to flash the green light, even though stocks are stretched to the downside here. This all adds up to keenly watching the quality of the next rally for signs of a meaningful trend change in the market.

Stocks are in the process of forming a low, but it's too soon to venture a forecast on if it will be a bottom or THE bottom from which a summer rally launches. With 2008 being the exception, in presidential election years, we often see rolling rallies and declines of 10% until THE low is seen during the fourth quarter.

If you have a 401K or other investment accounts and want to discuss how to best position, please don't hesitate to call me directly at 203.389.3553 or hit "reply" to this email.

Can You Trust the Pundits?

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One story related by Peter L. Bernstein in "Against the Gods: the remarkable story of risk" was the experience of Kenneth Joseph Arrow, an American
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economist and joint winner of the 1972 Nobel Memorial Prize in Economics.

Some officers had been assigned the task of forecasting weather a month ahead, but Arrow and his statisticians found that their long-range forecasts were no better than numbers pulled out of a hat. The forecasters agreed and asked their superiors to be relieved of this duty. The reply was: "The Commanding General is well aware that the forecasts are no good. However, he needs them for planning purposes."1

Philip Tetlock, a psychologist at the University of California, Berkeley, has literally spent a lifetime looking at how well experts in their field do with respect to their professions. Over a period of 20 years he collected the predictions of 284 people who made their living "commenting or offering advice on political and economic trends," including journalists, foreign policy specialists, economists and intelligence analysts. By the end of the study, Mr. Tetlock had quantified 82,361 predictions. How did the experts do? The vast majority of the predictions were worse than random chance. Post graduate degrees offered no advantage. Famous experts tended to do the worst.

Where did these individuals go wrong? According to Mr. Tetlock the main reason was overconfidence. Convinced that they were right, the experts ignored evidence suggesting they might be wrong. Another important bias is that most experts find it very difficult to make a negative prediction. Fear of "crying wolf" may be part of the reason, but there is also a desire to please the audience and be re-elected, or asked to speak again. Another important cognitive bias, Mr. Tetlock points out, is that most of us find it very difficult to change our minds.

Overconfidence and "confirmation bias," where experts ignore evidence suggesting they are wrong, are of particular concern to investment advisers. With the financial security of our clients at risk, we can't afford to become "prisoners of our preconceptions," as Mr. Tetlock puts it. This is one reason why active management relies heavily on non-emotional, technical and quantitative analysis and mathematical relationships within the financial markets. Our goal is objectivity and discipline, checking our ego and emotions at the door. The most important information for an active manager is not where the market has been or where we believe it is going, but where it is today.

By setting very specific investment rules as to when an asset will be purchased or sold, or when it is safe to be invested in equities or bonds or a specific sector, or when a defensive posture is better, our goal is to avoid letting our biases and emotions influence our decisions. I may be right in my belief that the market will recover from its current malaise, but to base a client's portfolio on that belief ignores the consequences of being wrong. What if I am right on the market's direction but completely wrong on the duration of the problem?

Active management is risk management. As with all tools to limit risk, it can also result in lost opportunities if conditions change quickly. But without risk management, without basing investment decisions on where the market is today, the risk of a major drawdown impacting the client's future increases.

1 Against the Gods, Peter J. Bernstein, page 203.

Upcoming Appearances

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ET NOW's Trading Calls - June 27 at 10:30pm

Fox Business' Markets Now - July 9th at 1:00pm

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

"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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