March 4, 2013

11:30 AM EST

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Inside this issue

Government Crying Wolf Again

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So here we are again. From the debt ceiling debacle in 2011 to the election to the fiscal cliff in late 2012 to the sequestration now, we are getting constantly barraged with Washington's dysfunctional behavior. And we have learned, until we get to the absolute point of no return, our elected officials just posture and pander to the media. The sequester deadline and has come and gone and yet the sun still came up, the economy hasn't fallen off the cliff and the markets continue to drive to all time highs. Imagine that!

The potential cuts will certainly have a negative impact, but those won't be felt immediately nor will they be all at once. Over the course of the year, unless a deal is made, we should expect roughly 1/2% to be cut off of GDP growth. In a strong economy, 1/2% doesn't mean a whole lot, but in an economy that is struggling to grow at even 2%, 1/2% does matter.
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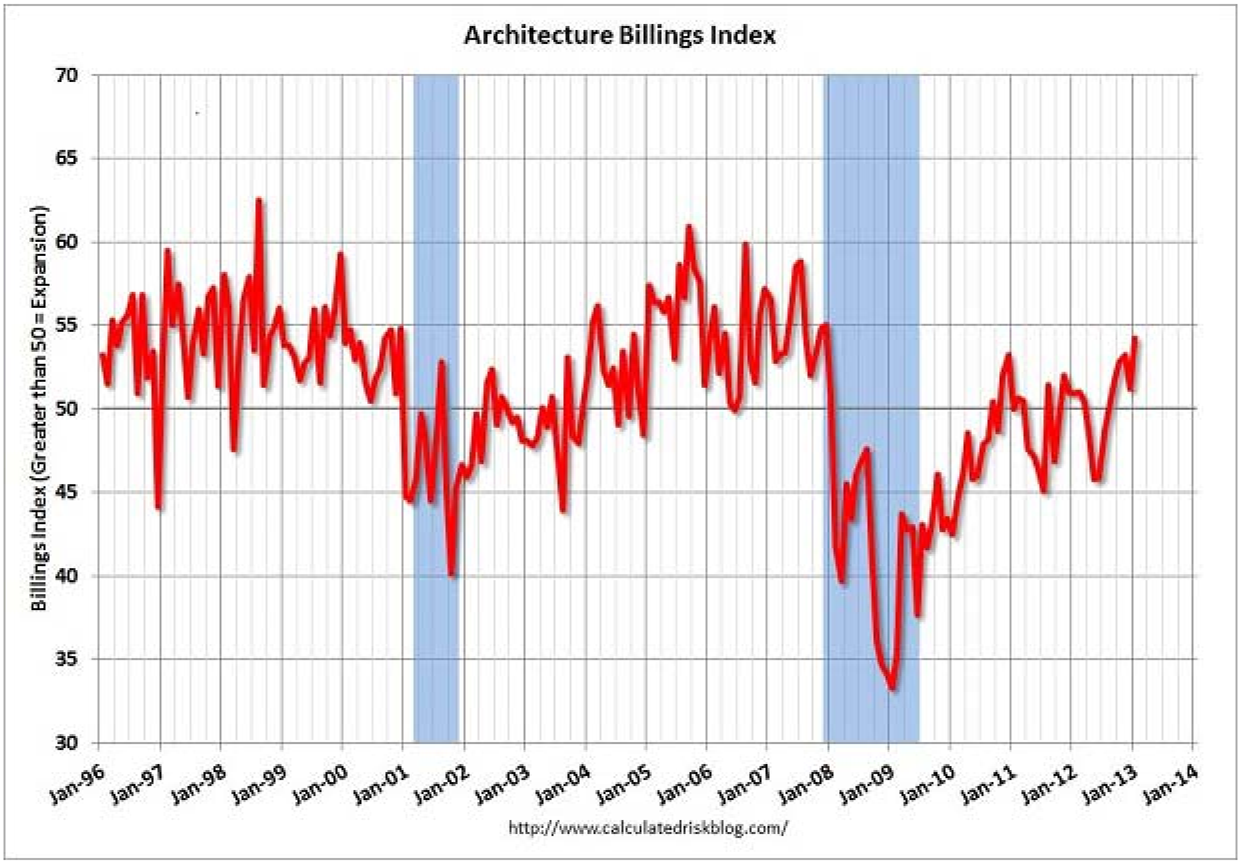
On that, below you can see one of my favorite off the beaten path indicators that I show from time to time along with the Restaurant Performance Index. The ABI gauges how architects are doing as strength with that group typically translates into commercial projects 6-12 months down the road. As you can see, this index recently hit a new post recession high in January and that is a good sign for our economy... for now.



Turning to something very near and dear to my heart, over my kids' February break (like they really needed one after being out of school for a week from the blizzard!), the family headed to Vermont to ski. Below is a picture of my little guy who at 4 years old was about to assault his first black diamond trail, much to wife's dismay. But he was a champ, turning and carving his way down to the bottom without falling and without a stop, much to his father's delight and excitement! Boy was I proud!!

Finally, I did an interesting interview on CNBC's Squawk Box last week with Joe Kernen. You can watch that **HERE** (http://www.investfortomorrow.com/InMedia.asp). I am scheduled to be Fox Business on March 8 and back to an old CNBC favorite, Worldwide Exchange at 5:30am on March 14. I will confirm via Vestorly shortly.

Speaking of Vestorly, hopefully you are receiving the weekly digest that is emailed every Thursday morning around 8am along with any intra-week items. If not, please let me know!

Canaries Still Alive

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In mid January, I published an article in this issue, **All Time Highs on the Way for Stocks**, where I reviewed the regular piece I do on the market's canaries in the coal mine. Usually before a bear market begins, we see many warning signs in key indicators that despite what may look good on the surface with the Dow Jones Industrials, the foundation of the market is already in bad shape.

In that piece, with the exception of the NASDAQ 100, the major stock market indices were all in gear to the upside and I was expecting to see all time highs across the board. Nothing has changed in that regard. The S&P 400 Mid Cap and the Russell 2000 Small Cap indices have already traded in all time highs territory and I think it's only a matter of time before the S&P 500 and Dow Jones follow suit.

Another indicator I closely watch at major tops and bottoms is the cumulative New York Stock Exchange advance/decline line seen below. That's just a fancy name for tracking the total number of stocks going up and down each day on the NYSE. Along with the Russell 2000 and high yield bonds, this indicator is a good barometer of liquidity in the financial system. As you can see, there are no bull market ending warning signs here yet.

I mentioned high yield or junk bonds above as another bellwether of liquidity. These kinds of companies typically represent the riskiest pool of the bond
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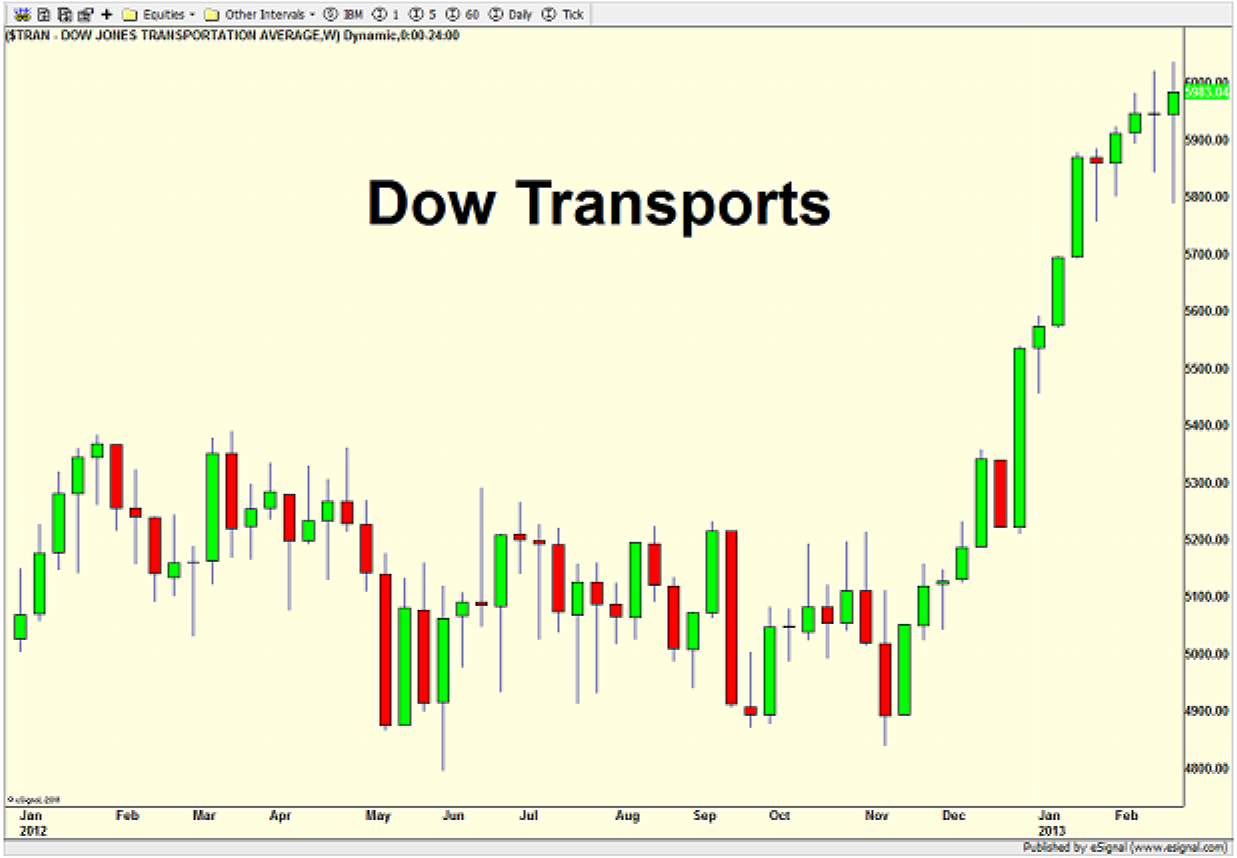
market, which is why they pay the highest interest rates. They sit at the bottom of the credit food chain and are incredibly sensitive to ripples in the economy as these companies struggle. So when junk bonds are performing well and leading, liquidity is typically very strong. When they begin to diverge from the major indices, it is an early warning sign of a trend change.

Below you can see a chart of the PIMCO High Yield Fund, which is a bellwether for the junk bond sector. I could have easily chosen other funds or ETFs but this will do the trick. You can see that the fund peaked in mid January and has basically treaded water since as the stock market continued higher. That is only a mild cautionary sign. What would concern me much more is if we saw stocks shoot higher to all time highs and junk bonds make a new low for 2013.

I am not going to include that charts of the financial and semiconductor groups since they look very similar to the S&P 500, but I am keenly watching how they behave if and when the S&P 500 scores an all time high.

The Dow Jones Transportation Index, long a laggard and worrisome index, did a complete 180 at the November 2012 bottom and has become THE sector leader, a very good sign. Before this bull market dies, I expect the Dow Industrials and the Dow Transports to diverge, meaning that one makes an all time high but the other does not.



All in all, stocks are trading very well, but have a very long way in a short period of time. The normal, healthy and routine 2-6% pullback could come at any time, but until proven otherwise, buying the dips is the strategy to use as long as we don't see the canaries start to die.

Please feel free to contact me directly by hitting reply to this email or calling the office at 203.389.3553 if your portfolio is not behaving the way you would like or if only to bounce an idea off me.

A Key Missing Ingredient... Money Velocity

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When will the current economic malaise end? Will the next infusion of government spending, new money from the Fed or debt forgiveness put the U.S. economy back on track?

It's doubtful. The reason can be found in two very interesting graphs from the Federal Reserve Bank of St. Louis. The first shows the explosive growth of money using the broad indicator M2. The second shows the velocity of all that money in a nose dive.
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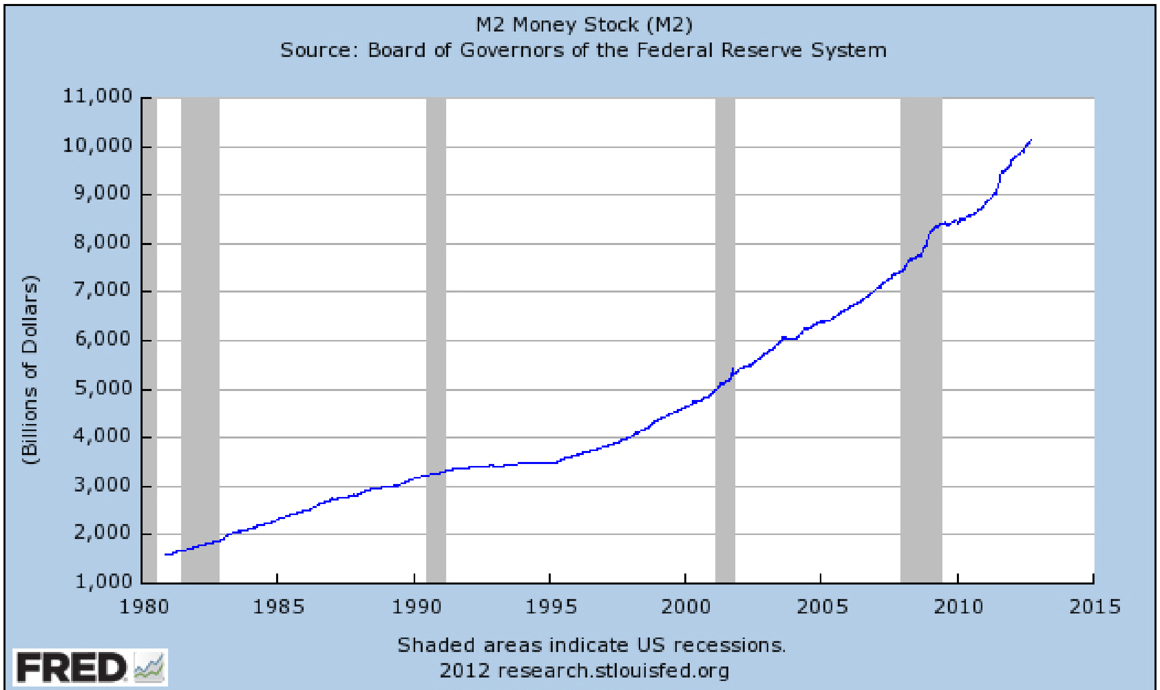

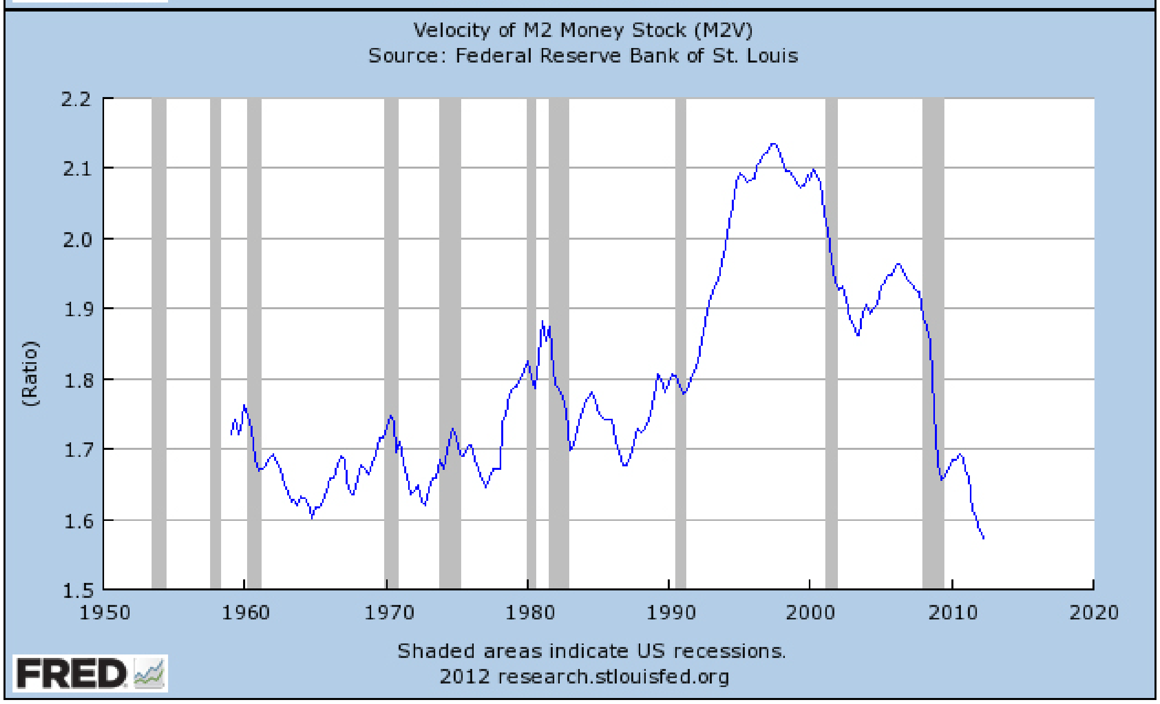

M2 includes a broader set of financial assets held principally by households. M2 consists of M1 plus: (1) savings deposits (which include money market deposit accounts, or MMDAs); (2) small-denomination time deposits (time deposits in amounts of less than $100,000); and (3) balances in retail money market mutual funds (MMMFs).

For a succinct definition of the velocity of money, we turned to Wikipedia - The velocity of money is the average frequency with which a unit of money is spent on new goods and services produced domestically in a specific period of time.

The U.S. economy is awash in money right now. Banks have largely rebuilt their capital reserves and businesses are holding record amounts of cash. Total U.S. money market mutual fund assets topped $2.555 trillion in July 2012 according to the Investment Company Institute.

Consumers have reduced debt levels. In the U.S., household debt has now fallen to 84% of GDP from a peak of 98%. Non-financial corporate debt has fallen to 77% from a peak of 83%. Financial sector debt has plunged from 123% of GDP to 89%.[1] While many experts believe debt needs to fall further to reach a sustainable level, private balance sheets are looking much better.

The federal government has poured money into the financial system through government borrowing (public debt has risen to 89% from 56% of GDP) and Federal Reserve purchases of long-term debt from banks and government lenders. If money does indeed make the world go around, the economy should be humming. But it isn't.

The reason why shows up very clearly when you look at the velocity of money.

Why has velocity fallen so dramatically? The typical rationale is that banks are refusing to lend the infusion of capital they have received since the first TARP funds. But the banks claim they would gladly make loans if qualified borrowers would just apply. But since banks tightened credit standards after getting burned so badly, a much smaller percentage of the population now qualifies.

Retail merchants would gladly sell, if buyers would just buy. What seems to be missing is confidence...confidence that spending money today makes sense in terms of what's coming down the road. Given the debt ceiling debate in Congress during the summer of 2011, election, Fiscal Cliff in 2012 and now the sequestration, it is very difficult for the average American to have much confidence in anything our leaders do! Without that confidence, it is very hard to be optimistic on the economy. For consumers the question really is "Can I afford to spend this money or am I going to need it for essential expenses next year or the year after?"

If and when Washington gets their act together, we need to see steady improvement over time of economic indicators, employment data and personal income. Long time readers know that there are no quick fixes, but time, common sense and some good old fashioned compromise will go a long way towards the launch of the next great economic and stock market boom in America.

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[1] "U.S. debt load falling at fastest pace since 1950s," By Rex Nutting | MarketWatch - Jun 8, 2012.
"Data Source: FRED, Federal Reserve Economic Data, Federal Reserve Bank of St. Louis"

Upcoming Appearances

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CNBC's Squawk Box - February 26 at 6:10am

Fox Business' Markets Now - March 8 at 1:00pm

CNBC's Worldwide Exchange - March 14 at 5:35am

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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"The only easy day was yesterday."
- The U.S. Marines

"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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