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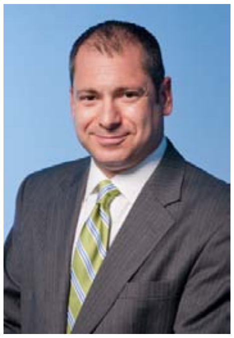

Written by Mitchell O. Goldberg, May 6, 2009.
ClientFirst Strategy, Inc.
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What do you do now?...Crossroad…Dow 9,000 ceiling?

The question on investor's collective mind is whether the 30% plus stock market rally since the 2009 current low is the inflection point or not.

Cut through the clutter…Buy or Die…a few key points…

First, the longer I wait to write this, the more the news improves on the economy. Granted, much of it is "not as bad as we feared" stats, but stocks were braced for Armageddon-type news. Most of this news comes with caveats, hence, making it tough for investors to decipher a sticky inflection point in the economy. For example, read the next 5 bullet points:

1. Existing home sales improved. But it was because of marked down prices on the part of desperate sellers and a glut of foreclosed homes.
2. New home sales showed improvement. But that was due to sharply marked down prices on the part of desperate home builders.
3. Retail sales figures showed improvement. But that was due to substantial mark downs at stores and due to pent up consumer demand, since consumers closed their wallets for about 6 months.
4. Automobile sales came in better than expected. Fine, but the numbers were still horrific.
5. Also, rising unemployment data, foreclosure activity, and an exploding budget deficit didn't just go away. This equates to tough days to come, but these data points are considered lagging indicators. The main thing is whether or not they improve.

The list goes on. But eventually after a good deal of positive stats, investors need to start realizing that maybe there really is something here. There are simply too many positives to be hell bent on clinging to an environment that was overweighed in negativity. Not to imply that everything is rosy, far from it, it's just to say that **the news is at least more balanced in terms of good news vs. bad.**

What's happening now, in the simplest of terms, is that mutual fund and hedge fund managers are in the position of having to "buy or die". Investors must always keep in mind one very important emotion of fund managers, **performance anxiety**. In the ultra competitive world of money management, year end performance figures are everything. The strategy has changed from liquidating positions before the next guy (so the manager doesn't do as badly as his/her peers) to having to buy before the next guy (so the manager may outperform his/her peers). The higher the market goes while fund managers are sitting on cash, the higher the performance anxiety will go. The buy triggers will be pulled. With a lot of cash in fund managers' coffers, stocks have a lot of fuel to keep going higher. So, if you are looking for the simplest of explanations as to why the stock market just rallied so much, here's your answer. Despite being simple, this has been true since the beginning of the money management industry.

This is why the Chrysler bankruptcy, Swine flu, bank stress tests, and lousy but better than expected news hasn't killed this current rally. While on the subject of Chrysler, kudos to the small group of fund managers who hold Chrysler bonds, which are transferrable, and were blamed by the Administration for driving the automobile company into bankruptcy. What drove Chrysler into the ground was Chrysler. Whether or not these fund managers bought the bonds opportunistically or not, they are still holders of a contract. Capitalism is based on the "a deal is a deal" rule, and they should be applauded for exercising their legal rights as bond holders. This is not meant to be political, but rather an observation as seen through the eyes of investors.

Focus on extremes often focuses us on the wrong things…

Investors are bombarded with the term **"Dow 14,000"**. The fact is that the Dow closed above 14,000 on only 9 days (one day on July 19, 2007 and 8 days in October 2007). **"Dow 6,500"** is another term we'll no doubt hear more about. The Dow spent only 8 days in the 6 K's during March of 2009. Yet we don't hear nearly as much about the 16 months in between. I'll offer another term that we can pay some attention to, "Dow 9,000".

We hit this level on November 3, 2008 (the day before Election Day) and last on January 2, 2009. Both times were followed with the major indices plunging to new lows. How does that grab you?

It is NOT my sense that we do it again. The majority of S&P 500 member stocks didn't breach their November lows when the Dow closed at 6,547 on March 9, 2009. The Dow and the S&P 500 were brought down mainly on the backs of financial services companies, including GE. Only time will tell for sure, but we may have had our bottom test put in place. I'll list a few points and then tie it all together:

1. TARP, TALF, etc. have been put in place in order to keep the U.S. banking system and overall domestic economy operating. The Armageddon in financial services has been avoided. TALF (Term Asset-Backed Securities Loan Facility) is in place to aid asset backed securities, commercial mortgage backed securities, and credit card debt holders (and practically anything else that can help the banks).
2. **Monetary policy (as set forth and targeted by the Fed) is zero for the Fed Funds rate.** This was a key tool in rescuing the banking sector in 1990 too. This is also the single most important factor in helping our climb out of its funk. The banks' operating earnings rise due to incredibly favorable net interest margin expansion. Meaning, their cost of raw materials, money, is free. If you're products cost you nothing, how much better would your earnings be?
3. The Fed is moving to put smaller banks together into larger regional banks. There is a great deal in potential savings when combining banks due to potentially substantial gains from economies of scale.
4. The stress test for the nation's largest banks is about to be released. Rather than something that invokes fear, it is interpreted by investors as the near-end of the giant and necessary capital raises.
5. Operating earnings from companies across many sectors and companies have been positive, including real earnings as opposed to "not losing as much as expected".
6. The **residential mortgage refinance** explosion of very recent history (and still going on albeit a slower pace at the moment) will add hundreds of Dollars to millions of household budgets starting now.
7. **Inventories are dwindling. A rebuilding of inventory for all things we buy is an essential part of any economic recovery and a precursor to any economic expansion.** ***(Please refer to article from November 19, 2008)***
8. **Consumer confidence soared in the month of April (Reuters/University of Michigan) to the highest since the September '08 failure of Lehman Brothers. The National Association of Realtors Pending Home Sales Index rose** for two straight months. While two months doesn't mean a trend, it is another year over year number that has actually improved. It has been about 6 months since we've seen improving year over year figures for practically anything!
9. The Fed has said that the pace of economic deterioration seems to be slowing and that it expects interest rates to stay low for some time. It also said it remains vigilant about inflation.
10. The stimulus plan, while not nearly perfect, will no doubt help our economy.
11. I pointed out in previous articles that an increase in Mergers and Acquisition activity is a key indicator that corporate managements are confident about the future. M&A activity is on the rise. Most recently is Oracle purchasing Sun Microsystems. It has been nearly 10 years since the Tech Bubble popped and now the NASDAQ is the best performer this year of the 3 major indices. Tech stocks are finally washed out…and breaking out.

I'll tie it together:

1. Investors should evaluate their portfolios for necessary asset allocation changes. For example, if one's set allocation is 50% equity and 50% fixed income, but recently went to only 30% equity, they should consider the merits of reallocating back to 50% equity. And vice versa after this current rally; if the allocation went to only 30% fixed income/70% equity, one should consider the merits of reallocating back to 50/50.
2. Some measure of profit taking is prudent along the way. We'll all have plenty of new opportunities (a euphemism for down markets) to put cash to work. For hesitant sellers, stop losses are recommended.
3. Look to further diversify. Natural resources, from metals to energy to food, are showing signs of life. If one is waiting for inflation to take hold, it will be too late to add Nat resources to portfolios.
4. Aggressive investors could short Treasury securities. There is a simple way to do this using ETF's. This is how to play the popping of the fear bubble…and all bubbles eventually pop.

In summary, investor psychology has changed from selling rallies to buying dips. The change in sentiment is supported by improving fundamentals on both a macro and micro level. The stock market typically rallies 6 to 9 months ahead of economic recoveries and is, in my opinion, telling us exactly that. Just be prepared for some pretty big bumps along the way.

Thanks for reading this. Please forward this to anyone you know who may find it interesting. Please reply me if you'd like to comment.

Interested in becoming a client? Call me. Let's talk about it.

(Disclosure: This is solely MY opinion. Of course, you are welcome to share your opinions with me too. If you act on any of this without speaking to me first and you lose money, don't blame me. I may be wrong. I reserve the right to change my mind about any of this whenever I want and without warning. We're NOT totally out of the woods yet! Have a great day! ☺)

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