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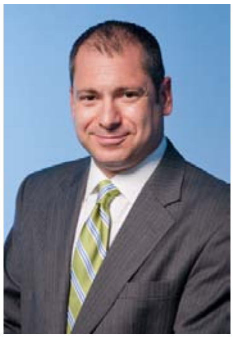

Written by Mitchell O. Goldberg, August 19, 2008
ClientFirst Strategy, Inc.
For immediate release.

The GOOD parts of BAD news and a moving target…

And why the stock market is so volatile

At this point in the downward slope of the stock and housing markets, it isn't too difficult for even the most detached investors to rattle off all of the bad news now. If by some chance you are still unfamiliar with what I'm referring to; all you need to do is watch the evening news. For the sake of brevity, I'll skip the litany of negatives impacting everyone and everything financial at this exact moment.

Rather, bad news is really the generator of good news. Before we go any further, this article will make sense only if you believe the economic world we live in is cyclical; meaning, history is a repeating mechanism.

1. **A weak economy gives way to an environment of low inflation AND low interest rates.**

Notice the recent and precipitous drop in all things commodities; oil, gold, corn, copper, etc? Notice that short and long term interest rates are at or near historic lows? This was the same environment that launched a bull market in 1991. It is doubtful that interest rates will rise due lowered inflation expectations for the foreseeable future.

2. **A seriously injured financial sector will give way to a major wave of consolidation.**

Just look at the consolidation in the banking sector; from over 14,000 banks pre 1990 to a little over 7,000 currently. Investors profited handsomely between the end of 1991, the end of another banking crisis, to the end of 2007. Remember Manufacturers Hanover, Shawmut, First Union, Fleet, and most recently North Fork? Like any other commodity, fewer players typically means that institutional money managers are forced to buy more shares of the remaining entities. I expect this trend to continue, even accelerate, over the near term.

3. **Lower housing prices, single family homes in particular, gives way to a new housing bull market in terms of price and activity.**

For the first time home buyer, the cost of purchasing became out of reach for too many. Do you think no one will ever buy a house again?! Once activity picks up a little, it becomes a self fulfilling prophecy. Houses are off the books of the banks, housing inventory drops, housing related jobs once again need to be filled, and durable goods orders (think washing machines, refrigerators, and furniture) rise. This brings us to the next item, Gross Domestic Product (GDP).

4. **Low and/or negative GDP gives way to rising GDP.**

Do the media ever remind anyone that GDP goes down AND up? Hey, I'm not at all for any kind of censorship whatsoever. But if all one hears is negative news all day and night, one may become a little slanted toward an overly negative view of the future. Negativity and optimism are like a pendulum; often too far in either direction with very little time in the middle.

5. **Cost cutting by surviving corporations gives way to increasing earnings per share and healthier balance sheets.**

Rising earnings per share and healthier balance sheets causes what? That's right, increasing share prices.

6. **Selling by weak and uncommitted share holders gives way to cheap stock prices.**

What happens to cheap stocks, being fundamentally sound of course? They go back up. Often, they go on to make new highs – again and again.

While none of the above is guaranteed to happen, it has always happened this way nevertheless. This is why this author remains grounded and patient and why he wants you to be that way too.

Like all moving targets, the one we need to hit is elusive. Since we've always hit it in the past, I have no doubt that we'll hit it again. The key is when will that be. **In this case, I refer to the day that banks begin to show an increase in lending again.** I have to ask; do you think banks are ever going to lend money again?! Of course they will!

If investors collectively think that the increase in bank lending will be in 12 months, they'll start investing aggressively between now and the next 6 months. If investors begin to push this day out to, let's say, to 2 years out, investors may not feel the urgency to invest aggressively for another 12 to 18 months. **It is my opinion that this moving target is the main cause of these wide trading bands in the stock market that we're seeing right now.** The strategy for long term investors should be to nibble during dips and rebalance strategically. They should include alternative investments that offer potential for growth but that are non-correlated to the other investments within their portfolio. The strategy for short term investors should be to buy the extreme negatives, be it in sectors or individual stocks, and sell on the belief that we're in for a long term rally. Traders are advised to use stop loss orders for everything.

To conclude, none of this is rocket science. It is simply the most basic tenet of how long and short term investors need to balance all of the news that they hear.

Thanks for reading this. Please forward this to anyone you know who may find it interesting (or amusing). Please reply me if you would like to comment on this.

(Disclosure: This is solely my opinion. If you act on any of this before speaking with me and you lose money, don't blame me. I reserve the right to change my mind about any of this whenever I want and for any reason whatsoever. Have a great freaking day☺.)