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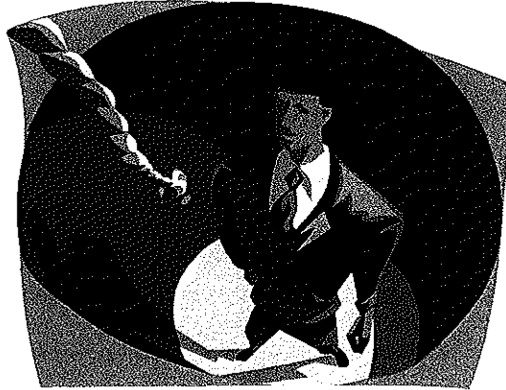
REGISTERED INVESTMENT ADVISOR



Stuck in a Rut: Mud is Thicker than Thought

For an economy "on the mend", the latest data has given us mixed signals and raised some legitimate concerns about both the recovery's pace and path. Rising joblessness, slowed consumer spending, and shrinking orders (both on the export and manufacturing fronts) are conditions for "spinning our wheels", not acceleration. But pinch yourself and remember we often pause and retreat, before we take off.

I must caution, though, that the recent dose of mostly negative news and data need to be examined more closely for the following reasons:

A.) As we know, the trailing data is just that; it is past tense. Therefore, since it is not forward-looking, extracting a trend from a month or so of information could be dangerous and could be a "false negative" in the whole scheme of things, as it does not necessarily mean that a whole new trend is upon us.

B.) We also know from studying history that the deeper the recessions, the slower (and more irregular) the rebounds. These rebounds are commonly punctuated by dull spots and pullbacks, so a reverse of mostly positive data could be merely a sign of that sluggishness and digestion. However, because we prefer the straight-line up rebound (with just little hiccups), the current mixed bag of metrics is disappointing and we, as investors, feel let down.

C.) If we were to sustain the slowdown for two quarters, the current five week-trend certainly becomes more entrenched and this would continue to worry and frustrate the financial markets. It will prevent rallies from gaining traction. This tends to increase pressure on Washington to do something. The upcoming mid-term elections (and subsequent outcomes – yet a big unknown) will be another row of key developments, as issues and perceptions will impact fiscal policy, stimulus, labor, and tax structure to name

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a few. Some pundits I talk with believe the "RUT" syndrome will be with us until more clarity surfaces.

D.) Watching Bernacke and what he says and infers will become more important to investors and analysts as the Federal Reserve and the nation's thirteen beige books have a tremendous and deep data base (watch for revisions and leaks, too). It is expected that the Federal Chair will offer insights and perspective, too, and keep the focus on forward progress and how to keep the recovery alive. The Federal Reserve has a few tricks left in the medicine bag to use and Bernacke has pledged to keep rates low, thereby not inhibiting the recovery's need for liquidity. [This was a debilitating problem during our country's Great Depression (1929 to 1939) and was at the heart of Japan's lost decade (1990-2000).]

E.) The lessons learned from the sharp May/June correction are not always appreciated until much later analysis and reflection can be done. By that time, the painful past news can seem almost irrelevant. My take-away is simple: We now know that the 15-19% correction in stocks was overdone and a sure overreaction to an outcome that did not occur in the Eurozone. However, the emotional reaction was more about reacting to the "unknown" or about reacting to the worst-case scenario that did not unfold. Lesson learned: This tends to be the market's preferred personality: paranoid schizophrenia. We must remind ourselves that many novice investors (and most day-traders) react emotionally first. We are well aware that the emotion can get carried away (often within the same day or week), for better or worse.
Letting rational thinking prevail in your decision-making can be difficult in these swaying times, but CAM is there to help you stick with your objectives or make changes as appropriate. Reassessing comfort levels and strategies never hurts.

Certainly, uncertainty has been the mantra of this recovery. Anything that adds to the murkiness or thickens the mud keeps the stock market "stalled" in gear. Three days "down", two "up", one "flat" follow the headline news and that's where the markets go. The trading ranges have been fairly narrow and constrained for 2010 so far. As the DJIA's downside resistance seems to stick at 9700/9800 while the "topper" has been 11,000 (plus or minus a little). In helping you understand these perplexing cross-currents which are responsible, let me make five points:

1.) In terms of the stock market and industry sectors, no clear-cut leadership has emerged. The "industrials and natural resources" theme has had to move over until the global recovery picture is more convincing. But, all in all, P/E valuations remain attractive (14x's) versus historic barometers (19x's). CAM continues to closely identify the factors and fundamentals that point to where the winners are or will be.

2.) Trading volume on the major stock exchanges seems to shrink and dry up (only 65 to 70% of normal volume) and this condition is dually typical at the book-end points (@ 9800 or 10,800) and then we see basing behavior, waiting on headline news to signal a turn or confirm the rut. This phenomenon has happened six times here in 2010. Volume is often synonymous with the VIX (volatility) factors, too, so CAM watches the VIX closely to spot those turns.

3.) Insider buying is on the improve (rise). Translation: Some of the notoriously "smart" money smells a bargain. Current buy/sell ratio is a bullish 5/2, which is not always a slam-dunk signal, but encouraging.

4.) The "flush out" or cathartic sell off (often witnessed in the last year of trading) is not occurring much. (In fact, only two of the last twenty "down" days that started with a "down" open.) This implies a degree of stability compared to that roller coaster volatility of May when the news and rumors were changing daily. This can come back to haunt us, unfortunately, as the markets do seem hypersensitive.

5.) Money flow has been moving to both high yield stock and bond funds for the **return**, **value opportunities**, and the **"safe haven" play**. CAM has identified the best of the best in these categories and feels this could be the most prudent "core" approach, while picking up bargains here and there on the selloffs.

In closing, CAM wants to highlight the fragile nature of the financial markets at the moment. We seem to be at a tipping point but are more overwhelmed by the checkmate of political and economic conditions. In one regard, we could be happy about the second quarter report card of corporate earnings... As 82% of the S&P 500 list of companies (a good proxy for large cap stocks) met or beat the street while 66% maintained or increased future guidance (especially projections for the future) and 15% increased their dividends. This (four quarters in a row) backdrop is fairly bullish **commentary** that a recovery is in place and that a trend line has been established. Recent cross-currents and unknown factors about the future have challenged the bull-tinted convictions, but please remember the complexity of coming out of a deep recession certainly complicates the recovery's trajectory. We must respect the pullbacks as question marks about the future. Consequently, CAM's selection process for picking investments will remain concentrated on **sound fundamentals, intrinsic value, and safety**.

Please feel free to touch base with me at any time. Happy Labor Day; I wish everyone a very safe holiday.

With best regards,

JC
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