

July 8, 2009

Greetings,

In my last investment letter; I stated that with any kind of improvement in the economy, we will see a major stock market rally, if not the end of the bear market. The most recent quarter was one of the best quarters that the stock market has had in the last 25 years and its best in 10 years. The S&P 500 had its first quarterly gain since the third quarter of 2007. Considering how bad the economy was a few months ago, it didn't take much to show an improvement.

The economy is still in a recession. The main reason the stock market has taken off so rapidly (another example of the utter futility of timing the market) is that 3 ½ months ago, the market was priced for a depression resembling 1933. If you look at the YTD return of the S&P 500, on the surface it doesn't look all that great even though we are doing very well. The situation is that in early March, the S&P 500 was down somewhere between 25-30% (when you are down so much I don't find the precise amount all that important) so that even though the market is barely in positive territory YTD, it has made a huge move in a very short period of time just to get to break even for the year. Once the people on Wall Street realized that there will not be a depression similar to the early 1930's, there was serious buying interest in stocks trading at decade lows. At this point in time, I think that even the most pessimistic people understand that the economy is not going into a depression. There are still plenty of people who are looking to talk down the stock market. Many of these people are hedge fund managers who missed out on the market rally and who are looking to get in.

Historically, the stock market is forward looking. One of the reasons it is a good idea to purchase stocks in a recession is because if you wait until the recession is over, you will pay much higher prices. The stock market moves up in anticipation of better times in the future. That is what is happening now. The consensus is that the recession will be over either late this year or early next year. My gut feeling is that it will be over sometime later on this year. Since the economy is similar in nature to a big ship and the recession is so deep, it will feel like we are still in a recession even though according to the government's statistics, it could be over. An example of why it will feel like we are still in a recession is the labor market. The labor market is the last thing to come back. While lay off's should abate, companies will be reluctant to hire people for awhile.

As far as the stock market, I expect a decent pull back any week and it looks like it has started now. Pull backs or corrections (depending on which terminology you prefer) are normal. During the strongest bull markets, the market rarely went straight up. 1995 was the only year that I remember that the market went straight up since I have been investing going back to 1985. Right now there is a tug of war between those who believe that the market has come too far too fast and the long term investors who insist that stocks are cheap and the best is yet to come. I also hear some talk about whether the bear market is over and if we are in a new bull market. My thoughts are that if it walks like a duck and it talks like a duck, then it is a duck. The stock market is behaving like it's a bull market.



Much of the bad news is being discounted. The market has been rallying on bad news on relief that the news wasn't as bad as expected. In a bear market, any kind of bad news would send the market careening lower. Corporate earnings have not been good but the earnings have not been nearly as bad as expected. What is important is that the guidance going forward has been better than expected and many analysts have been raising earnings estimates for later in the year and for next year.

Our mutual funds, as a group are doing really well. I have been much more active the last year and a half. It is nice to see that my efforts are showing tangible results. I do expect to do some fine tuning (nothing major) in the near future.

Please give me a call or send me an email if you have any questions or if there is anything that you want to discuss.