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Investment Strategy
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Investment Strategy

"I'm Back"

I'm back; back from what my analysts refer to as the "death march" through Europe. Why a "death march?" It's because you see portfolio managers (PMs) all day in one city and then jet off to do the same thing in another city the next day. For example, last Tuesday I saw three different accounts in Zurich in the morning (an hour meeting each), spoke to about 40 PMs over lunch, saw two more accounts in the afternoon, and then flew to Vienna to speak at a dinner for 12 PMs. The next day I did the same thing in Geneva before flying that evening to Milano, but I digress. My sojourn began two weeks ago with an opening salvo in London. After doing CNBC Europe, and seeing accounts, I hosted a dinner for 15 PMs. It was an interesting exchange of ideas and after copious amounts of wine I stopped the various conversations and asked each attendee what their biggest fear was. The responses went like this: 1) fund managers that only use mutual funds and exchange trade funds (ETFs); 2) investing is practiced in a too complicated a fashion when it should be easy; 3) a military coup in Greece; 4) inflation goes down instead of up; 5) China sells half of its Treasury Bonds; 6) Europe and the U.K. don't tackle their pension problems; 7) there is blood in the street, but the markets trade higher; 8) most of the unemployed are un-hirable; 9) the EU doesn't stay together; 10) water; 11) I used to worry about Ireland, but I don't anymore (now that's funny); 12) over regulation; 13) if the EU breaks up, what happens to the boom in German exports; 14) the fact that only 11 residents in Greece declared annual incomes of one million Euros or more; and the best – everyone is so negative that when the blue skies arrive they will be ignored.

Indeed, I visited 10 European cities over the last two weeks, and spoke with roughly 200 PMs, most of which were bearish and/or very bearish on U.S. equities. Their fears centered on our country's debt situation, the dollar, and most importantly, the debt ceiling. It seems there is a genuine belief in Europe that the U.S. debt ceiling won't be increased, leading to a default with an attendant rating downgrade. The Europeans don't understand the political gamesmanship currently being played that will be resolved with a debt ceiling increase at the "last minute." Nor do they understand the political consequences of social security checks stopping and public services shutting down. This becomes even more glaring 15 months before a Presidential election.

I tried to explain that Americans are pretty upset with all politicians, which is why the watershed mid-term elections showed a trend toward not electing professional politicians. Verily, I think the trend going forward is going to be electing people that have actually been in the private sector and know how to run a business. The era, in my opinion, of "the government is here to help you" is over. That view was reinforced recently by a Rasmussen Survey that showed 72% of Americans favor the free market economy over one managed by the government. Accordingly, I think the constituency of Congress is going to change, with seven lawyers for every MBA in the House and eight lawyers for every MBA in the Senate, the time has come for practical people instead of professional arguers; maybe that is what the stock market is sensing.

The real surprise of the trip was a weekend in Warsaw, where I spoke to 18 pension fund managers. Poland's economy, equity markets, and currency are booming. Said boom was fostered by some really good decisions from their practical government leaders years ago that have taken root. Cheryl and I took a four-hour private tour on Saturday with a gentleman that grew up under the Communist regime. He noted that he had to wait years to be able to buy a Yugo car. Now you see Volvos, Mercedes, and BMWs roaming the streets. The food at Warsaw's best restaurants was terrific, with a typical meal costing $40 per person including wine. I wish we had time to make it to Krakow, hopefully on another trip. The people were fantastic; friendly, happy, willing to bend over backwards to help, and why not given the "boom" they are experiencing. In fact, the Warsaw experience makes me want to look at some of their banks for investment. To be sure, we were VERY impressed with Warsaw and can't wait to go back.

The funniest experience of the trip came when we returned to London last Friday. I was again slated to spend the day seeing accounts; and sure enough, I spent the whole day doing just that. In the last meeting of the day, the PM said, as we adjourned the meeting, "I have read your missives for 11 years and always find them not only insightful, but entertaining, which is pretty rare on Wall Street. However, I REALLY like a man that is so self confident he can wear two different styles of shoe on each foot!" With that I looked down only to find I had spent the entire day walking around London with two differently styled black shoes and began to laugh. Apparently when I rose Friday morning, not wanting to awaken Cheryl, I dressed in the dark and put on one black English Brogue Wingtip and a black Ecco walking shoe. Alas, in this business it pays to be different, or rather "out of the box" (no pun intended).

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Speaking of "out of the box," the equity markets had been in a "out of the box" rally for the past few weeks, until Friday's employment numbers. As our economist Scott Brown wrote:

> **"**Not good, and the markets were caught leaning the wrong way following Thursday's better-than-expected ADP number (not the first time the market's been faked out by the ADP report). There are *no positive signs* anywhere in this report. This report is a major disappointment (a negative for stocks and a plus for bonds), but it doesn't really tell us much about what to expect in the second half of the year. The economy is likely to improve in the second half, but the pace may not be especially strong."

I actually like the fact the numbers were disappointing since they are backward looking and because it will give us a chance to see how much downside traction the sellers will be able to muster. My guess is it won't be much. This is confirmed by the astute Lowry's organization, which writes:

> "Lowry's primary measure of investor Demand, the Buying Power Index, has decisively broken a downtrend dating to the February market high. In addition, the Short Term Index has broken a downtrend dating to late December '10, while on a very short term basis, the 30-day moving average of Net Upside Volume has broken a downtrend [line] dating to mid January. These signs all suggest a change in pattern, that is, from weakening to strengthening Demand. At the same time, Supply continues to contract, with the Selling Pressure Index recently at a new low for the bull market and at its lowest level since November '04."

My sense, therefore, is that the S&P 500 (SPX/1343.80) spends the next five to seven sessions vacillating between 1320 and 1350 until the equity markets' internal energy is rebuilt for a move higher. Last week I suggested the SPX was extremely overbought based on a number of finger to wallet ratios and the 1340 – 1346 might contain the rally for awhile. Thursday's perky ADP numbers allowed the SPX to better that level with a close of ~1353. However, Friday's figures erased the Thursday thrust, as well as partially correcting some of the overbought condition. Consistent with these thoughts, I would continue to accumulate favorably rated stocks, many of which have been mentioned in these reports.

The call for this week: After three 90% Downside Days in June, July 1st registered a 90% Upside Day. That Upside Day was accompanied by a surge in Demand, as well as the steady increase in Demand that preceded it. Additionally, the New York Composite Advance/Decline Line is at a new rally high, implying the advance has been broad based. Then there is the D-J Transportation Average (TRAN/5548.66) that has traded to new all-time highs, registering one half of a Dow Theory "buy signal." If the D-J Industrials (INDU/12657.20) march to a new reaction high above 12810.54 a full signal will be registered. All of this provides evidence that another rally leg appears to have begun. Clearly, I think the recent soft economic numbers are driven by one-off events like the weird weather, a 44% increase in gasoline prices, and the tragedy in Japan. Expanding on this, our friends at Bespoke offer the attendant charts comparing the 1995 Kobe earthquake with Fukushima. So, my sense is that the SPX will spend a few sessions oscillating between 1320 and 1350 until the equity markets' internal energy is rebuilt for a move higher.

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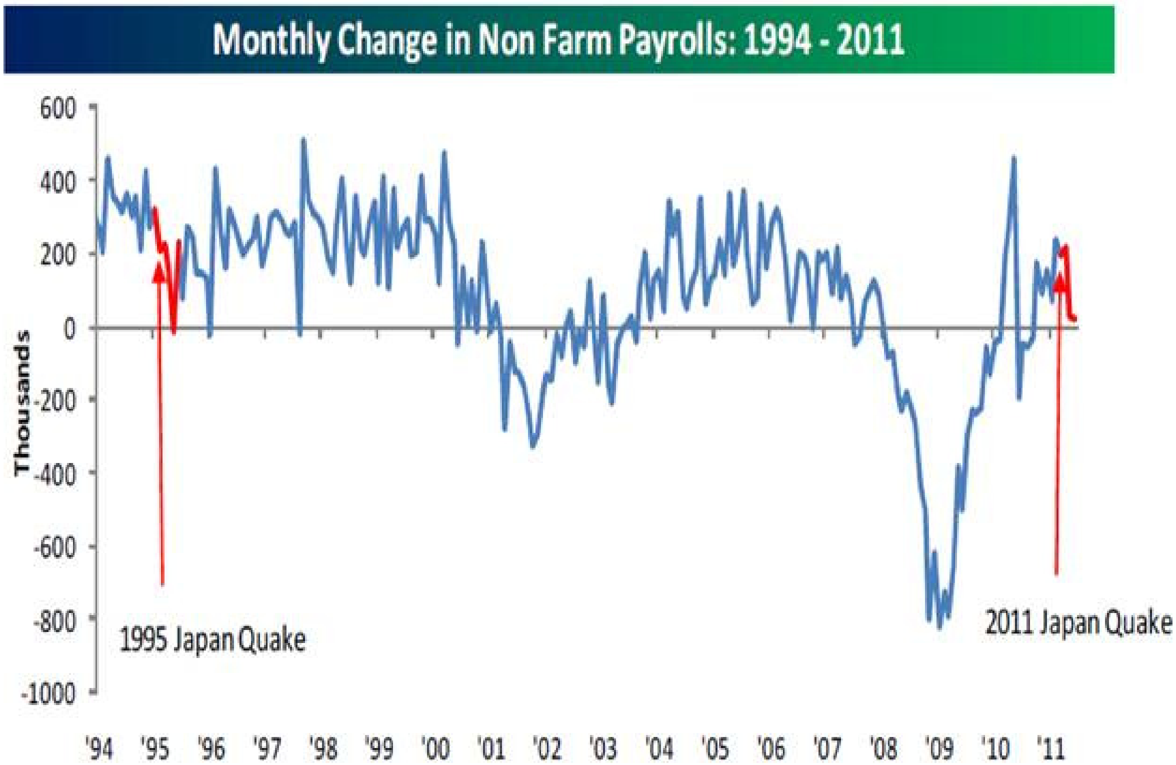

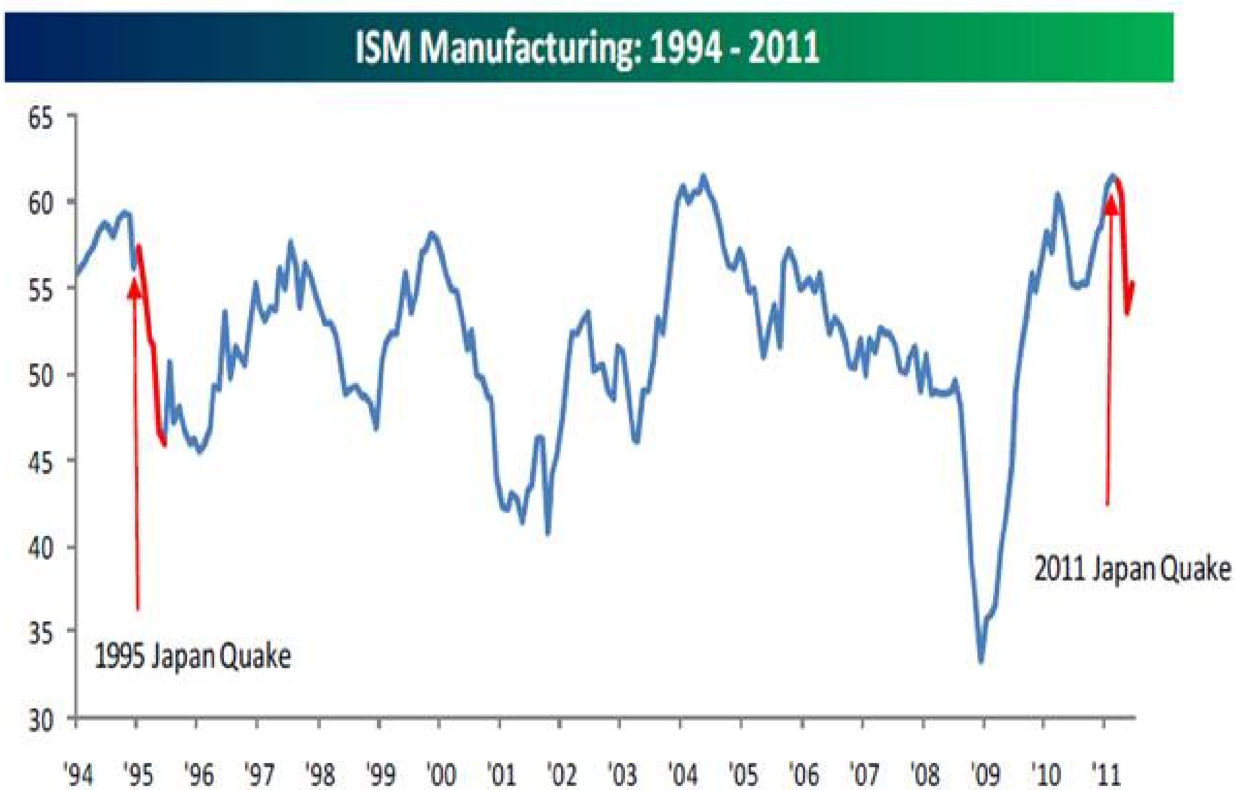

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