Jeffrey D. Saut, (727) 567-2644, Jeffrey.Saut@RaymondJames.com
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Investment Strategy

Lucky People

> "Recently I came upon a fascinating study by Richard Wiseman, a psychologist at the University of Hertfordshire. Wiseman surveyed a number of people and, through a series of questionnaires and interviews, determined which of them considered themselves lucky – or unlucky. He then performed an intriguing experiment: He gave both the 'lucky' and the 'unlucky' people a newspaper and asked them to look through it and tell him how many photographs were inside. He found that on average the unlucky people took two minutes to count all the photographs, whereas the lucky ones determined the number in a few seconds. How could the 'lucky' people do this? Because they found a message on the second page that read, 'Stop counting. There are 43 photographs in this newspaper.' So why didn't the unlucky people see it? Because they were so intent on counting all the photographs that they missed the message. Wiseman noted, 'Unlucky people miss chance opportunities because they are too focused on looking for something else. They go to parties intent on finding their perfect partner, and so miss opportunities to make good friends. They look through the newspaper determined to find certain job advertisements and, as a result, miss other types of jobs. Lucky people are more relaxed and open, and therefore see what is there, rather than just what they are looking for."
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> . . . Excerpted from *Ten Steps Ahead* by Erik Calonius

Yogi Berra once exclaimed, "You can observe a lot by just watching." Said quote reminds me of a conversation with my son. I was sitting at my desk looking at a chart of the stock market and shaking my head while muttering, "I don't understand if it's going to go up, or going to go down?" Hearing the frustration my six-year old son wandered over, looked at the chart, and said, "It looks like it's going up to me dad!" Out of the mouths of "babes," for that was in January 1986 after the DJIA had nearly doubled from its August 1982 nadir of 770 to the then "high" price of 1515. Sure enough it was indeed "going up," for over the next 19 months the Dow would nearly double again, peaking in August at 2728 and proceeding to churn into October, setting the stage for the 1987 Crash. Our son is now in his twenties and just graduated from the University of Michigan, yet the simple observation of an data-unencumbered six-year old is still relevant, "It looks like it's going up to me dad!"

Fast forward, since last June my unencumbered observation has been, "You can get cautious from time to time, but don't get bearish." That mantra has served us well, especial since last September, because beginning on September 1, 2010 the senior index has not experienced anything more than a one- to three-session pause/pullback making today the 174th session in its upside skein. Such a stampede is unprecedented in my notes of over 40 years. Still, "It looks like it's going up to me." As scribed in last week's report:

> "The bad news is that the S&P 500's (SPX/1363.61) rally from last Monday's sovereign debt drubbing downgrade has used up some of the stock market's short-term energy, implying another pause/pullback may be due. The good news is the market's intermediate and long-term internal energy readings remain almost fully charged and hence any pullback should be contained in the 1315 – 1320 zone."

I concluded by noting:

> "To be sure I am bullish, and while I didn't think the 7% decline from February into mid-March was 'it' at the time, I was indeed buying stocks and conceded two weeks after the March 16th 'low' that the intra-day 'print' of the S&P 500 at 1249 was likely 'the low.' Moreover, for the past few weeks I have suggested all the equity markets were doing was rebuilding their internal energy for another upside 'leg' that would break the SPX out above its February intra-day high of 1344."

Bingo, for last week the SPX leaped above that previous reaction high (1344), leaving the index up ~2% for the week. Moreover, the D-J Industrial Average (INDU/12810.54) recorded yet another Dow Theory "buy signal" as the D-J Transportation Average (TRAN/5514.87) surged to new all-time "highs" confirmed by the Industrial's rally to a new reaction high. It was the third Dow Theory "buy signal" of the past 10 months and reconfirms that the direction of the senior index is "up." Nevertheless, certain negative nabobs are chanting that with the SPX up more than 100% in roughly two years it is defying all odds and is due for a crash.

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We don't think so and would note the current "bull run" is actually pretty typical. As my friends at the invaluable Bespoke Investment Group write:

> "In the chart (found here on p. 3) we compare the current bull market to the 25 prior S&P 500 bull markets since 1928. With a gain of about 101% in a little more than two years (781 days), the current bull market ranks right near the middle in terms of duration (11th) and performance (9th). Not including the current period, the average bull market has seen a gain of 101.6% over a period of 890 calendar days. You can't get much more average than that."

So what's driving stocks higher? Well, for the last two years we have opined the economy was in a "profit recovery" whereby profits explode, which fosters an inventory rebuild and then a capital expenditure cycle. Once the capex cycle commences, companies begin to hire workers and consumption improves. That's the way the world works and we don't see why it doesn't play that way this time provided crude oil behaves. Manifestly, profits have surged, and continue to do so, with 73.8% of the companies that have reported 1Q11 earnings beating analysts' estimates while two-thirds (66.4%) have exceeded revenue estimates. And for those thinking the economic momentum is waning, consider that the inventory to sales ratio is below where it was at the depths of the recession and is therefore in position for another inventory rebuild. If so, the economic numbers going forward should strengthen.

As for the here and now, last week Buying Power strengthened and Selling Pressure contracted; and while the Buying Power Index has yet to tag a new reaction high, it is not far away. Accordingly, while the equity markets can certainly pause/pullback, our sense is any such counter-trend move should be brief and shallow as underinvested portfolio managers scramble to keep up with the Joneses . . . the Dow Joneses. In last week's missive we questioned that if the University of Texas endowment fund's 21.8% exposure to equities was anywhere close to being representative of all endowment funds, what would happen if there was shift in asset allocations towards more equity exposure? Asked and answered we reasoned, "To the moon in June!" And that is the way we are playing it as we expect on/off strength into June followed by the first potential downside vulnerability as participants worry about the end of Quantitative Easing.

Hence, our strategy is the same one we proffered last week. To wit, keep accumulating stocks with favorable risk versus reward metrics. In the past I have suggested names like The Williams Companies (WMB/$33.17/Outperform), EV Energy Partners L.P. (EVEP/$58.89/Outperform), LINN Energy (LINE/$40.38/Strong Buy), IBERIABANK Corporation (IBKC/$60.01/Strong Buy), Clayton Williams Energy (CWEI/$90.57/ Outperform), Hewlett Packard (HPQ/$40.37/Strong Buy), NII Holdings (NIHD/$41.61/Strong Buy), Teekay LNG Partners (TGP/$37.92/ Strong Buy), Stanley Furniture (STLY/$5.64/Strong Buy), and Peoples United Financial (PBCT/$13.70/Strong Buy), and Hospira (HSP/$56.73/Strong Buy), to name but a few of the companies rated positively by our fundamental analysts and mentioned in these letters recently.

The call for this week: Since February 18th most sectors have experienced decent gains with Healthcare showing the best at +7.8%. Only Technology and Financials have had negative returns, -2.0% and -4.6%, respectively. We think that if the rally extends these two sectors should play "catch up." Despite the recent stock surge, however, investor sentiment remains putrid at 37.9% bulls, as can be seen in the second chart on page 3. This contrarian indicator, combined with the aforementioned underinvested portfolio managers, keeps us walking on the sunny side of the street. And as I said last week, for those timid souls afraid to buy stocks, I spent hours with the folks at Goldman Sachs a week ago and became extremely comfortable with Goldman Sachs' Dynamic Allocation Fund (GDAFX/$11.23). The fund tends to smooth out the stock market's volatility (by about half), yet delivers almost the same returns as its more volatile competitors. For further information, please contact our Mutual Fund Department. This morning, however, the S&P 500 futures are sharply higher as the "Wicked Witch of the East" literally had the house fall on him, so follow the yellow brick road . . .

P.S. – I am still traveling and will be speaking at Raymond James' National Conference, so other than this missive these are the last comments for the week.

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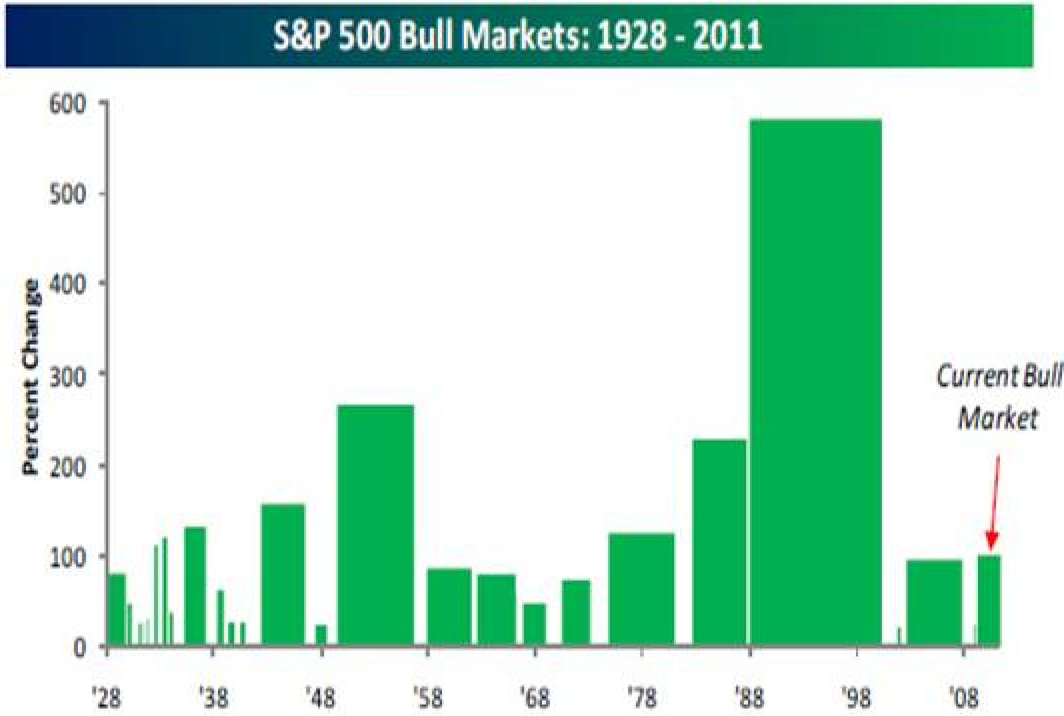

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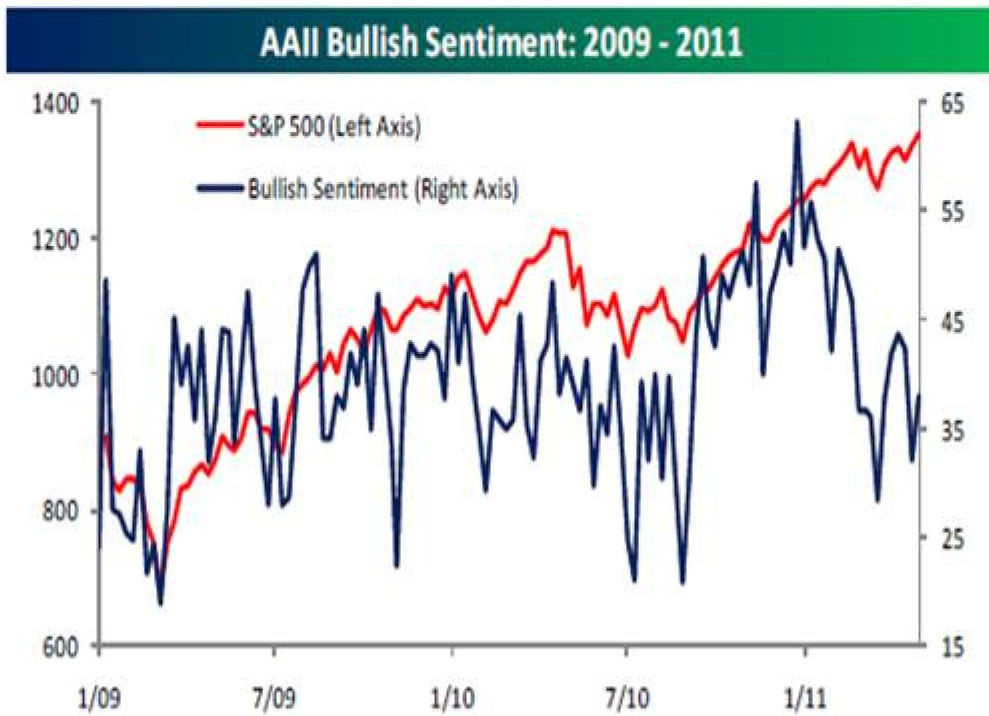

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