

"Pounded"

I have been "pounded" with questions about the Dow Theory "sell signal" I spoke of; and, that occurred three weeks ago. The ubiquitous question has been – "Hey Jeff, how can you tell people to buy in light of the signal?" My response has been that such a huge amount of energy had been used up in rendering the Dow Theory "sell signal" that the market, at least on a short-term trading basis, is likely a "buy." Reinforcing that view are numerous oversold readings of epic proportions. To be sure, one has to go back to the German Army's invasion of France to find a session where less than 2% of the stocks traded on a particular day on the NYSE were "up" for the session, which is what happened two weeks ago (8/8/11). Yet to readers of these missives, such action should not come as a surprise. Indeed, for the past three weeks I have likened the current selling stampede to those of October 1978 and October 1979. When studying the charts of those periods one finds said declines came out of the blue on no fundamental news; and while many people have argued there are plenty of fundamental reasons for the current decline, I am not one of them. The 1978 and 1979 declines were straight down affairs ending with "selling climaxes" (like seen on 8/8/11). Subsequently, there were sharp rebound rallies peaking within four to five sessions, followed by a downside retest of those "selling climax" lows. Accordingly, in last Tuesday's verbal strategy comments I said:

"If the October 1978/1979 sequence is correct, the throwback rally we are currently experiencing should peak in the 1200 – 1220 zone (last Tuesday's intraday high was indeed near our signal point 'throwback' rally high estimate of 1206) leading to a pullback towards the recent intraday reaction low of 1101. Nevertheless, I am still respecting the Dow Theory 'sell signal' until it is reversed. Opinions, however, vary for Richard Russell (captain of The Dow Theory Letters) suggests there has NOT been a Dow Theory signal because he is using the July 2010 closing lows for the D-J Industrials and D-J Transports rather than the March 2011 'lows' I have been using. For the record, those July 2010 closing lows were 9686.48 and 3906.23, respectively, which are a long way from the averages' current levels. Whoever is right, enough damage has been done that the May 2nd 'print high' of 1370.58 for the S&P 500 is likely the high for the year. The quid pro quo is that last week's 1101.54 'print low' is either near the low, or the actual low, for the year. This week should reveal the answer if my 1978/1979 analogy is anywhere near the mark. If so, that leaves us hopefully range bound between ~1100 and 1370 into year-end with my sense stocks will be at the upper-end of that range by December provided we don't have a recession, a view I continue to embrace."

My controversial non-recession "call" is driven by the fact that industry analysts are still bullish on earnings with the S&P 500's (SPX/1123.53) consensus estimate approaching \$114 for 2012. Corporate insiders are clearly bullish as they have been buying their own company's shares at the highest rate since the bottom in March 2009. Layoffs have slowed and while the economy is certainly slowing, metrics like L.A. seaport traffic, railcar loadings, etc. are not falling off a cliff like they did prior to the 2008 recession. Moreover, China and India's economies are still percolating; and as this week's Barron's writes, "It's Time to Buy: After a 20% pullback, emerging markets offer strong growth at a discount price." Then there is the European mess, which appears to be a little less of a mess, interest rates will remain tame for an extended period, it feels like tax reform is coming, and crude oil prices have collapsed. Indeed, change you can believe in is coming because according to *The Washington Post*, "The financially strapped U.S. Postal Service is proposing to cut its workforce by 20 percent and to withdraw from the federal health and retirement plans because it believes it could provide benefits at a lower cost." Ladies and gentlemen, if correct that implies the post office is not only going to break its labor agreements, but throw Obamacare under the bus.

Speaking of throwing Obamacare under the bus, an Atlanta Federal Court did just that by ruling that Congress exceeded its authority by passing the "individual mandates," which will surely be escalated to the nation's highest court; but, such developments has the administration doing some pretty strange "things" like calling for market-based solutions. One such market-based solution is already at work in Puerto Rico. According to *The Wall Street Journal* (WSJ):

"A stimulus program on the island, long ripe with vacant houses and condos, has sent sales of new homes surging 80% and sales of existing homes up 24% in the past 10 months from a year earlier, even as the market in much of the U.S. mainland is dead. . . . One of the incentive program's popular provisions offers qualified buyers down-payment assistance for homes purchased with a mortgage, as well as a second mortgage of as much as \$25,000 that can be used to make down payments and pay closing costs. Buyers of new homes also pay no transfer taxes when a property

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changes hands, escape paying property taxes for five years and future capital-gains taxes, and pay no taxes on rental income for 10 years. Sellers don't have to pay capital-gains taxes on profits.”

As stated, there is a change afoot inside the D.C. Beltway that is palpable and market-based solutions to our problems are but one example. As I told one of our more worried financial advisors last week, “We could solve the debt issue in very short order with a Value Added Tax (VAT).” While I personally would hate an insidious VAT tax, it would assuredly raise a lot of money very quickly. However, the real answer to our woes is economic growth. To that point there was an article in the *WSJ* on 8/10/11 titled, “A New Strategy for Economic Growth.” In the article quips like these appeared:

“Policy makers should cease the barrage of ad hoc, short-term policy initiatives. Is increased federal spending across government agencies a grand strategy? . . . The debt-limit debate caused policy makers to recognize what citizens already knew: We must put our fiscal house in order. Cutting spending is essential. But we will never cut our way to prosperity. So, what should be the economic grand strategy? In a word: growth. . . . Absent strong growth, any projected improvements in the country's fiscal position won't materialize.”

Obviously, I urge you to read the entire article.

As for the stock market, at the beginning of last week investors felt the worst was over emboldened by the previous week's Thursday/Friday +550-point fling. By the end of last week, however, we saw the mirror image with Thursday and Friday's 592-point tumble. Yet, that action should come as no surprise to participants who have studied the declines of October 1978 and 1979. As described in these missives, those 1970s patterns saw a selling climax “low,” like we just experienced on 8/8/11 (-635 DJIA) that was followed by a sharp “throwback” rally. Subsequently, the rally peaked within a few sessions with a downside retest of the “selling climax” lows. In the 1970s sequence those lows were marginally broken, but that was THE bottom and was followed by roughly a 13% rally over the next three months. Hopefully, that is the pattern we will see here.

Despite my hope the current stock market action will follow the October 1978 and 1979 bottoming sequences, the Dow Theory “sell signal” registered on August 4, 2011 worries me, which is why I am respecting it. Hence, I have not been aggressive with stock recommendations. Indeed, if I am to err I am going to err by being too conservative. That is why most of the stocks mentioned in these missives over the past three weeks have had outsized dividend yields and/or our fundamental analysts think they have already bottomed. Such names include: EV Energy Partners (EVEP/\$62.89/Strong Buy); LINN Energy (LINE/\$35.74/Strong Buy); Health Care REIT (HCN/\$45.84/Outperform); Campus Crest Communities (CCG/\$10.37/Strong Buy); Abbott Labs (ABT/\$49.08/Outperform); and Centurylink (CTL/\$33.70/Strong Buy), to name a few. Please see our fundamental research for the full story on these stocks.

The call for this week: Investors' worries have leaped to levels last seen in November 2008 as the stock market's bottoming process began when 92.6% of all the stocks traded on the NYSE made new annual price lows. Before that, the Global Risk Appetite Indicator I use shows “panic levels” equal to their current reading occurred at the “lows” of October 2002 and August 1982. Surprisingly, I was actually bullish at those “lows!” Regrettably, I am not as unabashedly bullish here; I wish I was! I would, however, observe that with the trade-weighted dollar at a record “low” U.S. trade should provide a boost to export growth, crude's crash should also help, low interest rates are a plus, the yield curve's shape is noticeably steep (read: bullish), inflation is low, auto production is slated to ramp in the months ahead, Japan's economy has bounced back, emerging markets' economic growth is percolating, the inventory to sales resides at levels around the recession lows, suggesting a economic “lift” from an inventory rebuild, capex projects are picking up, the global central bank interest rate “tightening” process is winding down, corporate profitability is exceptional, and banks/businesses have much larger cash buffers now than they have ever had. All of this leaves me in the NO recession camp and with the belief that select stocks are cheap. If that view is correct, we should see a “bottom” this week . . .

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