

October 9, 2009

The stock market has come back in a very big way the last six months. The economy appears to have stopped declining and, in many areas, has shown improvement. The surge in stock prices certainly implies an expectation that the economy will continue improving, but as I said in my July 9 letter, “I think the economy and the stock market have a bumpy ride ahead for the next several years, but it does appear that the worst is behind us.”

The negative news is that unemployment continues to rise; households took on a tremendous amount of debt in the early 2000s, and many consumers are using this time to reduce that debt (this is positive long term but a drag on the economy in the meantime); consumer confidence has dropped slightly, but fortunately the trend since February has been positive; defaults on prime mortgages are increasing, which could help lead to a new round of debt and banking problems.

The positive news is that major corporations announced the fewest number of layoffs during September than at any time since March 2008, according to outplacement firm Challenger, Gray & Christmas; the four-week average of initial jobless claims fell 6,250 to 548,000, the lowest level since January 24; the ISM manufacturing and non-manufacturing indexes are both now above 50 (any reading above 50 indicates expansion); corporate earnings reporting season starts this week, and if the reports are right on or better than expected, the market could continue to improve.

I recently read an article by Gary Alexander entitled “The Mob Got It Wrong . . . Once Again.” He said that every week, the American Association of Institutional Investors (AAII) asks their members where they feel the market is heading for the next six months. Over the years, their members (arguably among the most intelligent and well-informed private investors in America) average a slightly bullish bias. However, when the tally of bulls doubles the bears or vice versa, the market usually moves in the OPPOSITE direction. During 2009, the bears dominated in March and July. Those months were both excellent buying opportunities. Where are we now? For the poll taken during the week of September 2-9, the AAII membership is still net bearish: 44% bears, 37% bulls, and 19% neutral. Since their historic average is net 9% bullish, this net 7% bearish stance is 16 points to the negative side of the historical average, and that may be good news for bulls.

The bottom line is that there will always be a mixture of good and bad news. It’s important to maximize your return while keeping your risk of volatility as low as possible through effective diversification.

Best regards,



Mike Miller, CFP®