

Market Notes April 17th 2009

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A month ago we said that investor sentiment was shifting to a positive outlook and that we believed we had likely seen the market bottom. The economic data were showing signs of a slowing decline and perhaps a bottoming. We talked of and expected a potential market rally.

We did not expect a rally as strong as we have seen. In fact, if the rally continues at the current pace the markets could be in positive territory by the end of April. Be careful what you wish for. Lowe *fs* is concerned that the markets have come too far too fast. The shift in investor sentiment has been too extreme without a solid basis for sustainability of the recovery.

There are still economic challenges that must be addressed. In our view the housing market has not yet bottomed and industrial production numbers look anemic. We wrote over the past several weeks that corporate earnings would be one of the major drivers of the market. As the earnings have been released major financial companies (the very root of the economic and market crisis) have been reporting better than expected earnings.

What has peaked our attention this week is that the market rally has not been led by financials. Rather, financials have only moved slightly and the rally has been driven by the NASDAQ stocks. Lowe *fs* believes that for a recovery to be sustainable financial stocks must lead or be a major contributor.

It is possible that investors are waiting for the results of the bank “stress tests” which are set to be released next week before they commit to financial stocks. Our expectation is that the release of the stress test data will not be a major factor unless there is a surprise like a Citi looking bad (actually would Citi being in a precarious financial situation be a surprise?) Investors are expecting bad news. We don’t see this data moving the market substantially.

You may recall that last summer before the major market meltdown we spoke of the VIX (a volatility index) and investor complacency. Interestingly, if you look at market volatility and investor complacency as measured by the VIX we are approaching levels that we saw last summer (before the major market meltdown). The more complacent investors become the more severely they might react to bad news.

Investors are no longer worried about risk and that is a remarkable shift in sentiment in a very short period of time. Such a quick change in sentiment without a sustained rally in the financial sector is troublesome in the short term. We believe that the longer the current rally goes without any type of correction the more exposed the market will be to any bad news.

Have we lost our optimism? No not at all. We still believe we are moving in the right direction and that 12 to 24 months from now we could be in a sustained period of recovery. It will not be a smooth path to recovery. *Lowe fs* is simply making it clear that you should anticipate some down days or weeks on the way to recovery. These speed bumps or pull backs are a necessary part of a sustainable recovery.

If the markets do pull back we still remain firmly committed in our belief that we have seen the market bottom (absent an unanticipated catastrophic event). Any such pull back would likely be short in duration in our opinion. Investors who have cash to put to work would probably use any decline to invest thereby providing a potential catalyst for another possible rally.

The market movement of the past month demonstrates the importance of having money “in the game”. If you don’t you could miss much of the recovery. However, the allocation of where the money is and how much of it should be “in the game” requires ongoing analysis, research and a disciplined approach. That of course is what *Lowe fs* brings to the table.

Lowe fs continues to talk with Morris Segal of SPG Trend Advisors and Anirban Basu regarding strategic approaches and market analysis on a regular basis. We anticipate utilizing any market decline as an opportunity to continue to rebalance our actively managed discretionary accounts toward a strategy focused on potential recovery.

For the past year hand a half we have focused on preservation and very short term strategies. Now, with signs of recovery building (market recovery not economic recovery) we are beginning to shift toward a 12 to 24 month timeframe as we consider strategies. Translation: we might be a little early in certain sectors, but being early could provide greater potential rewards 12 to 24 months from now. We firmly believe that investors who continue to wait on the sidelines could see a recovery pass them by.

Don’t get us wrong. We are still retaining higher than normal cash in our actively managed discretionary accounts. Proactive defensive steps will be taken in these accounts if we deem it necessary. The difference now is that we are looking out 12 to 24 months with our strategies vs. daily, weekly or monthly.

Yes, we have more economic turmoil and bad news to sift through and the economy has a long way to go. But, the stock market has historically been a “leading indicator” that tends to react based on anticipated results rather than waiting for actual results. This means the market should be expected to recover before we see sustained economic recovery.

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