

## Cornerstone Commentary

### Key Points

- ◆ Events don't make a trend
- ◆ Washington's stimulus has not created recurring strength
- ◆ Expect short term corrections

### Strategy Update

08/14/09  
 John Riley  
 Chief Strategist

#### Events Don't Make a Trend

Our strategy can be put succinctly – I don't buy it. All of the happy talk from Washington and Wall Street about economic recovery and "green shoots" don't convince me one bit.

Here's the reason – to have true economic recovery, it needs be continuous, creating recurring income that is self-sustaining. Instead, what we have gotten from Washington are "one time" events. As a research analyst looking at a company, I discount the effects one time events have on a company's earnings, because they usually have no follow through, no creation of future earnings or revenue streams.

While big and expensive, all Washington has done is give the economy short term boosts that have no sustainability, but have costs that will be long term. (The debt needed to fund these boondoggles.)

Bailouts of failed banks and brokerages don't advance the economy at all, except in keeping the economy from collapse. They spent trillions propping up the big banks, yet have allowed over 70 smaller banks to fail this year. Interesting how this year many of the bigger banks have announced huge earnings after having received aid from the government. They get to keep their earnings, but we have to bail them out of their losses. I'm pretty sure that privatization of earnings and socialization of losses is not how a strong banking system (and economy) is built.

The economic stimulus package was mostly smoke and mirrors. Only about 14% of the almost \$800 billion went to infrastructure and science according to the Administration's own website, recovery.gov. Over half the "Stimulus" package went into tax relief and aid to States. This wasn't stimulus, it was a band-aid.

The socialized American auto industry has turned into a global joke. After spending billions to prop up GM and Chrysler, the government now has to pay customers to buy cars from them. And the Department of Transportation refuses to release the statistics on who is getting what. Are they afraid that the numbers will show most of the Cash for Clunkers money went to foreign autos companies like Toyota and Nissan?

What can we expect next? Bailouts of failed golf courses? \$500 for old refrigerators?

#### Band-Aids on an Arterial Bleed

They have done nothing more than put their finger in the dike. They prevented the collapse last year, but with all of the new debt piling up, they are creating more holes and more vulnerabilities. The OMB has put the price tag of all of the bailouts and guarantees at a cool \$23 trillion. That's about 160% of the economy, on top of the \$52 trillion of debt already in place. (Not to mention the \$99 trillion of unfunded liability at Medicare, Medicaid and Social Security! And these guys want to "reform" healthcare! If history is any guide....!)

Yes, some economic numbers may have upticks. Unemployment could decline for a bit. But they have done nothing to address the fundamental problems facing the US economy – too much debt and a deteriorating manufacturing base. Until these two issues are seriously addressed, there can be no real sustained economic recovery in the US.

There may be some green shoots, but they are likely to be poison ivy. If you give an addict more of what he craves, he feels better for a while, and then he's going to need some more. The economy is addicted to debt and instead of figuring out a way of reducing our dependence on debt growth, the Fed, Treasury and Administration have been orchestrating the biggest Federal deficits in history, funded by debt.

#### Give The People What They Want...

Bear markets have rallies. Economic downturns don't go in a straight line. The worst thing an investor can do is to get caught up in the hype of an economic recovery and new bull market. It may be what the people want to hear, but until certain fundamental changes happen, it won't be reality. And investors could get caught in a bull trap, as the market heads to new lows.

#### Review of recent charts:

Generally, many markets are extended. Short term pullbacks are the theme of most charts. It will be important to be able to discern which pullbacks are buying opportunities and which are not.

Fundamentals will play an important role. It is less important what people are saying and more important what they are doing. For instance, the Chinese are saying they support the US Dollar and will continue to buy US Treasuries at auction, yet their actions tell us something else.



*As Seen in*

**Forbes**

**Cornerstone Investment Services** has been chosen by Goldline Research as one of the **Ten Most Dependable Wealth Managers of the NorthEast**

## Key Points

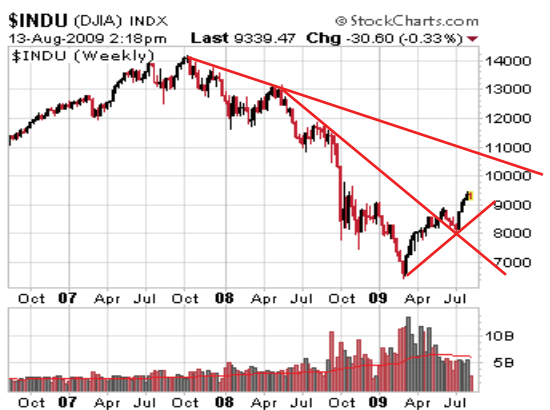
- ◆ Dow Jones has come too far, too fast
- ◆ Dow could rally to 11,000 or correct down to 7,000
- ◆ Investors should sell into strength

They have been entering into many international trade deals that have settled in Yuan, not Dollars. They also have been conspicuously absent from recent Treasury auctions and have reduced their exposure to our long term debt in favor of the shorter term.

### Dow Jones Ind



A gain of almost 50% from the low in March is too far too fast. Even if we were bullish, we would expect this to correct a bit. A decline to the 8600 area would hold support for the short term trend. The declining volume is working against the rally, showing it is running out if steam.



The longer term chart shows that the market could rally to almost 11,000. But the downside is a re-test of the March lows around 7,000. Wise investors should use any further rally to lighten up on US equity positions.

### China

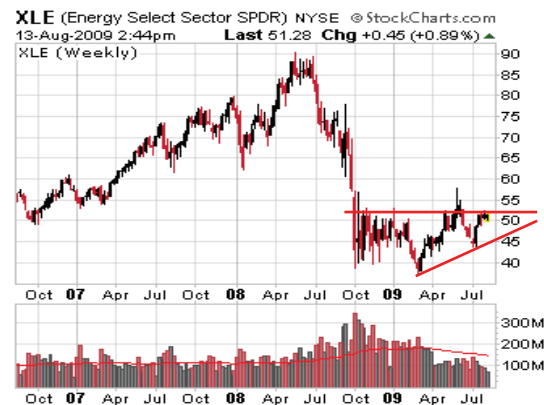


China has just about doubled from its March lows. This too is too far, too fast. This difference between the Dow Jones and China is that China's fundamentals are improving. There are many in the investment world that for some reason have it in for China. They will point to any correction as justification for their

negative views. You may hear talk about a bubble in China. It is ironic that many of these same strategist never saw a bubble in the US, but now they are experts on China.

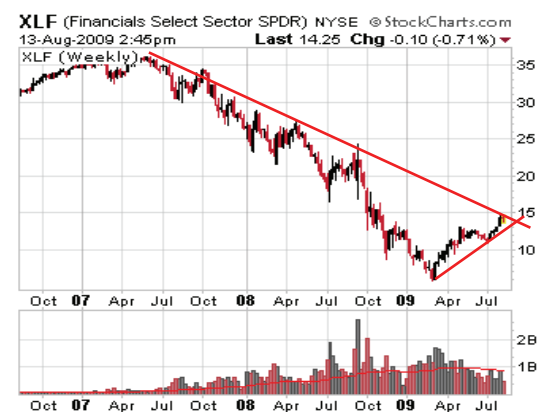
In our opinion, all of this talk of a bubble in China is wrong. Yes, we expect a correction, maybe even a severe one, but with improving fundamentals, buying China on a dip may be a smart move.

### Energy



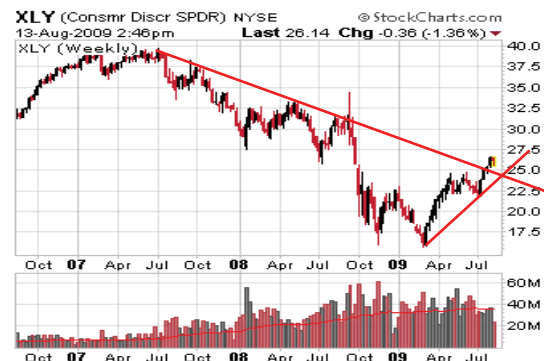
Energy hasn't moved much this year. Any further correction could be viewed as a buying opportunity.

### Financials



Financials have had a big move off the March low. This is based on deteriorating fundamentals. Many banks will survive and prosper, but it is still too early to play this area. Sell into any strength.

### Consumer Discretionary



This group is the poster child for foolish investing. With all we know about rising unemployment, consumer debt numbers and record personal bankruptcies, Consumer Discretionary stocks should be one of the last sectors to move, yet the chart shows it breaking out

## Key Points

- ◆ US Dollar is still the key
- ◆ Gold trying to get through \$1,000
- ◆ Oil's short term moves may be determined by the Dollar
- ◆ 30yr Treasury rate has been climbing, we expect it to go higher

Bullish Percent Index shows "everybody's in the pool"

of its down trend. Wise investors should be selling into strength.

### US Dollar



Long term, we expect the Dollar to head much lower. But, short term, we may see a rally. After hitting new lows for the year, it may reverse and rally. Breaking down below 77.50 would indicate the declines will continue. A break above 81 could mean a further rally.

### Gold



Gold has attempted to clear \$1,000 several times this year. The Dollar could be a key player in its success. If the Dollar rallies, we would expect to see Gold fail again in its attempt to get over \$1,000. If however, the Dollar declines further, it may cause Gold to accelerate well beyond \$1,000. On its own, Gold looks like a chart about to go much higher. The Dollar may be the key.

### Oil



Similarly to Gold, Oil future may be tied to the Dollar. Long term fundamentals continue to improve, but

short term, the Dollar may be in charge.

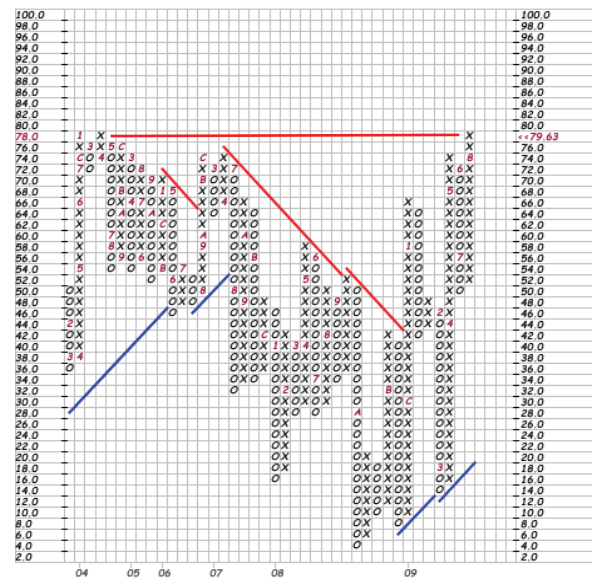
### 30 yr Treasury yield



Long term rates have risen significantly this year. Granted, they came off an extraordinary low at the end of 2008. But the Fed's buying of Treasuries announced in March was supposed to keep long term rates down. Instead, they rose over 100 basis points. How much higher might they have gone had the Fed not been buying? We may soon find out as the Fed announced they will stop buying Treasuries in September. This may have implications for the Dollar, mortgage rates and the health of the economy, none of which will be good.

### NYSE Bullish Percent Index

**NYSE Bullish Percent Index (EOD) (\$BPNYA) INDX**  
 12-Aug, 16:00 ET, daily, O: 79.637, H: 79.637, L: 79.637, C: 79.637, Chg: +0.605  
 Status Bull Confirmed on 20-Jul-2009  
 User-Defined, 2.0 pts/box 3 box reversal chart



The Bullish Percent Index (BPI) measures how many stocks are in bullish trends. A reading of 70 means 70% are in bullish trends. A reading of 25 means only 25% are in bullish trends. It can be an indicator of a reversal of direction for the market. Once the chart gets to extremes, it usually reverses, as does the market.

Currently the BPI is at 79.63. The last time it was this high was 2004. This is higher than last summer or the summer before. It is telling investors that everybody is in the pool. It could stay at this reading for some time, or go even higher. But if 80% of all

## Strategy

- ◆ Sell stocks into strength
- ◆ Buy fundamentally strong areas on corrections.
- ◆ Continue to hold fundamentally strong areas

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1-888-277-5968

(outside Rhode Island)

**Providence Office:**

**(401) 453-5550**

**Dallas Office:**

**(972) 563-8990**

**Email:**

[johnr@cornerstoneri.com](mailto:johnr@cornerstoneri.com)

**Cornerstone  
Investment**

**Services, LLC**

**245 Waterman St,**

**Ste 301**

**Providence, RI 02906**

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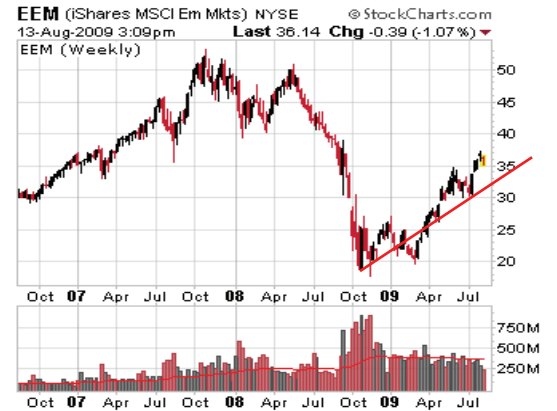
stocks are in a bullish pattern, what is likely to be the next move in stocks?

Put this information together with the previous charts and you can see why we anticipate at least a short term correction in the US Stock market, if not a resumption of the bear market. Investors that are caught up in the euphoria of the rally may want to re-think their positions. Wise investors should take advantage of the current situation, selling into strength and preparing for a decline.

### Our Strategy

Our strategy at Cornerstone is just that. Sell into strength and look to buy sectors with strong fundamentals. We are not likely to get completely out of certain markets. We will continue to hold those areas where fundamentals are strong. We will be looking for buying opportunities (lower prices) in those areas.

One area that looks particularly attractive fundamentally for the long term is the emerging markets. Although we expect a significant correction, we will be looking to add to this area in the future.



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