CORNERSTONE
INVESTMENT SERVICES, LLC

Cornerstone Commentary

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Highlights

- **Fed's interference in markets will eventually not work**
- **Not every dip is a "Buy"**

Buying vs. Selling Opportunities

John Riley
Strategist

XYZ just dropped 20% this morning! Quick! What do you do? Buy or sell? For over a decade, Wall Street and the Fed have conspired to teach investors that every blip downward, every big drop in prices, every decline was a buying opportunity.

And thanks to the moral hazard they have created, they have generally been right. A couple of Wall Street's mantras are "buy and hold" and "buy the dips". This has been made possible by the Fed's enabling actions. When there is a major decline, the Fed comes along and lowers rates, flooding the system with liquidity and buoying up a market that should have headed lower.

I say "should have" because declines, major declines, are a natural part of a stock market cycle and of an economic cycle. But the Fed has become a populist bureaucracy, more concerned with their own legacy than a healthy economy. So they continue to serve beer to an economy drunk with too much debt. The normal economic hangover that every cycle has is getting put off by the Fed's interference. And the longer it is put off, the worse it is likely to be.

At some point in time, the Fed's interference will not work at all. Some can point to the past 9 months or so of the Fed dropping rates, trying desperately to bail out the market, the economy and the banking system all at once and failing to make a difference. Today's banking problems are getting worse, the economy is slipping further into recession and the stock market is clearly rolling over. Forget about a real estate recovery!

So investors have to be smarter than the bartenders at the Fed. (This shouldn't be difficult!) They have to recognize that while some declines are a buying opportunity, some are not. Knowing the difference between a decline that is a buy and one that is not makes all of the difference in the world!

Everybody is focused on the here and now, what have you don't for me lately? They want to know that today is going to be okay, and worry about tomorrow another day. This is why the Fed drops rates. They fix today but add more debt to tomorrow's mess, making it even worse. Let somebody else worry about tomorrow.

We take a different view. We look at trends and fundamentals. These two factors tell us whether a decline is a buy or not.

For instance, with global demand rising and supplies limited, would a drop in the price of oil be a buy? Yes. The long term trend for demand is rising and this translates into higher long term prices. But what if oil were to drop 20%? Still a buy. The fundamentals haven't changed. A decline is a true buying opportunity, until the fundamentals drastically change.

With a recession looming, real estate still crashing, unemployment rising and banks taking billions in write-offs, is this a good environment in which to invest in stocks? So a decline in the stock market, is it a buy?

Of course not. Not until the fundamentals have a huge turn around. What is our single biggest factor preventing that from happening? Debt. And since it is likely going to take years to solve our debt problem, stock market declines are not buying opportunities, and they won't be for a long, long time.

Highlights

- How does $200 billion in new loans fix a debt problem?
- Don't get caught up in the daily market "noise"
- Focus on fundamentals and trends

Since the Fed adds debt to the system every time they lower rates or put cash into the banking system, are they helping or hurting the long term health of the economy? They are hurting it.

So here's a trick question – Today the Fed made available $200 billion in loans to banks so that they can loan more money. The stock market reacted like it was Christmas, opening up an astounding 260 points. Is today's jump in the market a buying signal?

No. It is a selling opportunity. Remember what the Fed did. They added more debt to the already overloaded system. This is a negative for the economy, not a positive.
But the market reacted positively, why? Because they are short term oriented. They are not looking at the long term impact. They just want to know that the Fed has put a band-aid on the problem.

So the fundamentals have gotten worse, but the market is up. What does this translate into? A selling opportunity. This is a great time to get out of the stock market. Stocks that were down yesterday have been given a gift of a few points today. A smart investor sells into market strength when the economy is worsening.

It takes a clear head to sift through the noise of the market. You can't let yourself get caught up in the emotions of the day, whether is positive or negative. Long term fundamentals don't change on a dime like investor sentiment does. Staying focused on the long term trends will help investors distinguish between what is real and what is just the crowd noise.

Fundamentals tell you whether a decline is a buying opportunity or not and fundamentals tell you if a rally should be sold or not. Mixing them up can have devastating and long lasting consequences on a portfolio.

At Cornerstone, we don't let the noise of the day sway us. We remain focused on the fundamentals and trends, and invest accordingly. We won't get fooled by the Fed's panic bail-out schemes.

Questions, comments, further information, to set up an appointment or request forms, call: Toll Free: 1-888-277-5968
(outside Rhode Island)
Providence Office: (401) 453-5550
Dallas Office: (972) 563-8990

Cornerstone Investment Services, LLC
245 Waterman St, Ste 301
Providence, RI 02906