

Highlights

- ◆ Bear Markets Have Rallies
- ◆ Debt to GDP Ratio is higher today than in 1929
- ◆ Bear Market Rallies Fail
- ◆ Bear Market continues until fundamentals change

Craziness Today, Sanity Tomorrow

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Let's take a look at some of today's headlines:
Doubts Greet Treasury Plan on Regulation
US Corporate Bonds Sales Fell 32% in the 1st qtr
Banking Industry to Cut 200,000 Jobs
Banks Face Biggest Crisis in 30 Years
UBS to Write Down An Additional \$19 Billion Related to US Real Estate
Chrysler March Sales Down 19.4%
Auto Sales Remain Weak:
GM Posts 19% Drop
USA 2008: The Great Depression

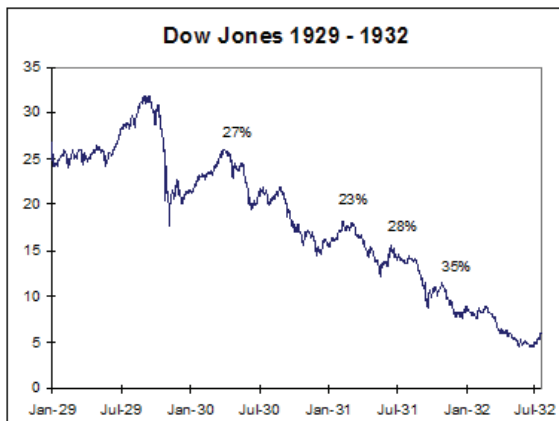
This is no April Fools joke. These were yesterday's headlines. And the market? Up almost 400 points. With these headlines as a backdrop, investors decided it would be a good day to buy!

Bear Market Rallies

As with all bear market rallies, and that is all the recent rally is in our opinion, investor enthusiasm overflows into the markets with great abandon. Investors want to know everything is going to be alright and have a decidedly positive attitude, all the way down a bear market decline.

Before we look at yesterday's action, let's look at bear market rallies through history.

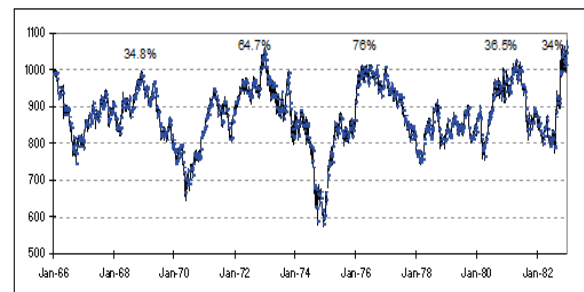
The Crash in 1929 was not a one day, one month or even one year bear market. It lasted almost 3 years and wiped 90% off the market.



But in the meantime, there were several substantial and relatively long bear market rallies. Some of the rallies lasted over 6 months and the chart above shows some of the rallies had gains over 25%.

Unfortunately for investors, the poor fundamentals of the economy overtook their enthusiasm and the decline that had started in 1929 continued. Debt was the major economic drag. It hit a peak of 270% of GDP soon after the market's peak in 1929. (To put this in context, today the Debt to GDP ratio is over 300%. The ratio is under 150% in normal times.)

Decades later, investors were treated to the torture of the 1970's. The Dow Jones peaked in 1966 at 999 and didn't get and stay above 1,000 until 16 years later in 1982. But there were some incredible bear market rallies as the chart below shows.



Every time the market rallied, it ran right into the poor economic fundamentals. The major economic theme was inflation and a slowed economy. The 5 bear markets had losses of -26%, -35.5%, -45.2%, -26.4%, -23%. Ouch. Each bear market rally was greeted by a vicious bear on the other side.

Bear market rallies are not just a phenomenon from the past or an American problem. Japan's stock market, the Nikkei, peaked in 1989 at about 40,000. It didn't bottom until 2003, down 80%. (And only time will tell if that bottom will hold.)

But the bear market rallies were tremendous. One rally more than doubled the market, two were up about 50% or more and one was up 25%.



As Seen in

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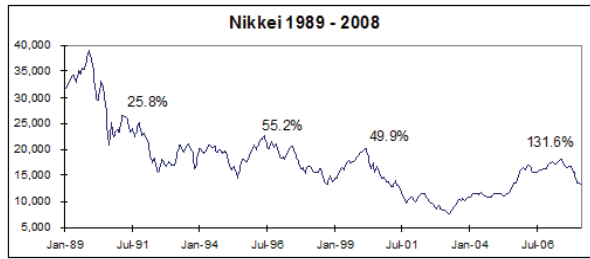
Investment Services has been chosen by Goldline Research as one of the **Ten Most Dependable Wealth Managers of the NorthEast**

Highlights

◆ Bears caused by the same things: Debt Inflation Deflation

◆ Bear Market rallies are selling opportunity

When all was said and done though, the rallies gave way to the deflationary trend of the economy which was weighed down by the excessive debt burdening their economy.



Lessons From History

What does this history lesson have to do with today's market? The US economy is faced with similar problems, but instead of just one or two, we have all three - debt, inflation and deflation. (See [Icebergs](#), 12/03/07)

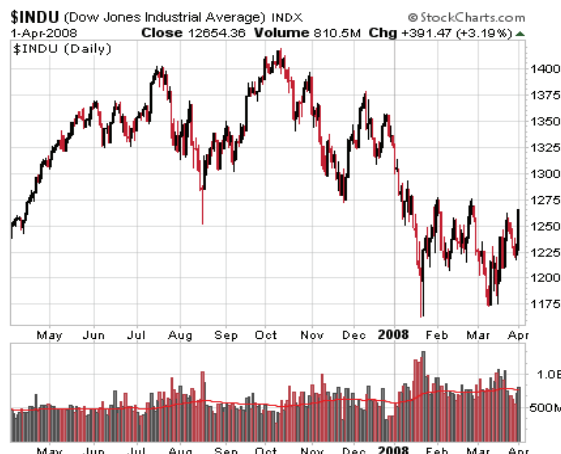
- 1 – **Debt** - The debt to GDP ratio is higher today than it was in 1929.
- 2 – **Inflation** – Global demand for commodities is pushing inflation higher.
- 3 – **Deflation** - Competition from abroad and domestically is limiting pricing power, putting us on the verge of deflation.

We know what the fundamental condition of the economy is. We also know that history shows us that it takes years for these scenarios to play out. So when investors see the market rallying, should they get excited about the rally, or put it in the context of the underlying economic reality?

But aren't the Fed's actions fixing the problems? No. Simply put, almost everything the Fed is doing is adding more debt to an already overburdened economy. More debt won't get us out of our economic mess, it only makes it worse. (See [A \\$145 Billion Dollar Cup of Irish Coffee](#) and [The Fed Buys A Round](#))

Current Market Recap

Below is a recap of the market action on April Fool's Day.



The almost 400 point gain was impressive, even explosive. But when put into context of recent performance, it failed to break above resistance.

The trend for the market is down and yesterday's action doesn't change that. Resistance is at 12750 and support is about 11750. A move above resistance could signal a reversal of the trend while a move below support confirms the downtrend.

Banks and Brokers both had big days yesterday as the euphoria of bailouts danced in investors eyes. (Blinding them to the reality that lies ahead.)

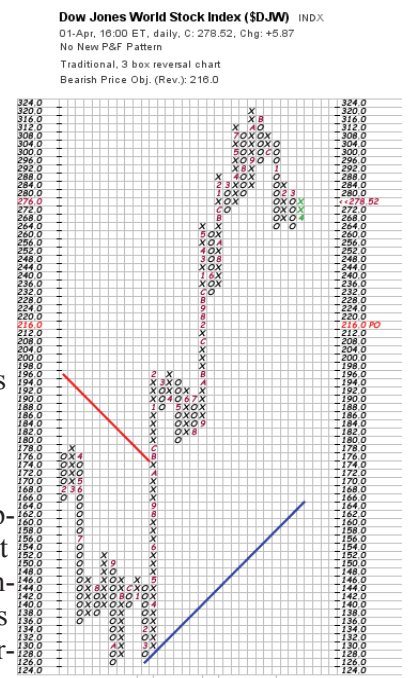


While the single day's gains were exciting, the recent trend down has been horrendous. A bounce up is always expected with downtrends like these below.

While the banks look like they may have double bottomed, resistance is still at 90 and then 95. Support is around 77. A break below confirms the downtrend, a break above 95 could mean there is a reversal in the banks. Our bet is that banks stay in a trading range for a while until the next shoe drops.

The Dow Jones World's chart is still one of the scariest charts we watch. Although it has come down a bit recently, it still has a long way to go to its bullish trendline.

The first area of support is about 264. The computer puts its downside target at 216. Its



Highlights

◆ **Gold and Oil have gone too far too fast, correction expected**

◆ **Dow Jones World Stock Index looks scary**

bullish trendline is all the way down at about 166/168. This tells us the upside is limited to a possible trading range while the downside is significant. This is why we have recently added more ETF's to hedge international equities.

Gold has been declining for the past couple of weeks. All sorts of reasons have been given, but the charts make it clear.



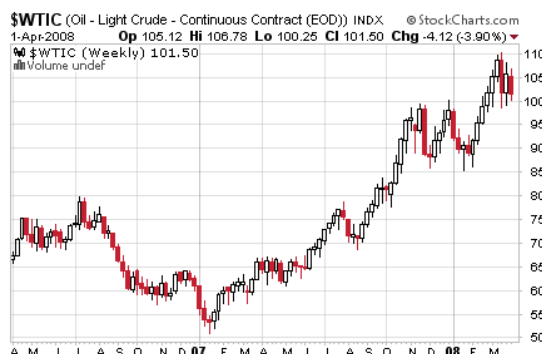
Gold raced up to 1000 from about 650 in a little over 6 months. Too far, too fast. A reversal was expected and the recent declines do nothing to reverse the uptrend.

Gold's rise has been in response to the Dollar's decline. The recent action by the Fed has given some strength to the Dollar.

But the recent strength has not been enough to reverse the Dollar's long term downtrend.



The Dollar's decline has been in response to inflationary policies by the Fed. Lowering interest rates and flooding the markets with liquidity only stoke inflation further. The Dollar's decline is not any where near over in our opinion and as indicated by the chart above.



Oil has had a very bumpy ride for the past few weeks. Some even point to the recent failure to make a new high as a sign that oil's bull market is over.

Looking at the longer term chart of oil you can see that it also went too far, too fast. A pullback was expected and a drop to 90/bbl shouldn't surprise anyone. A pullback to 80/bbl might even be in the cards.

A price decline doesn't change the fundamentals of increasing demand with limited supply. (Which adds up to higher long term prices for oil.) It gives us a buying opportunity.



Above is a chart of Oil Stocks. Curiously, it was up yesterday while the price of oil was flat.

The longer term chart for Oil Stocks shows that they peaked and declined well in advance of oil itself. They seem to have double bottomed recently. This could be setting up a sideways trading range or, if it fails at about 1325, a new leg down. A rise above the 1425 area could signal a breakout for oil stocks.

With fundamentals on their side, erring on the side of bullishness is warranted.



The Oil Services index may have broken out of its trading range yesterday and a move above 290 would confirm this. Still a drop to 260 or even 250 wouldn't surprise me.

What does all this mean for investors?

First, bear markets have rallies. They can prematurely get investors excited that whatever ailed the economy is behind us. People that get caught up in bear market rallies can get hurt very badly.

Highlights

- ◆ **Bear Markets have rallies, don't be fooled by US equities rally**
- ◆ **Bull Markets have pullbacks, don't be fooled by commodity correction**
- ◆ **Professional Money Management keeps focused on long term trends**
- ◆ **Fed Bailouts will cause long term damage**

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Second, bull markets have pullbacks. I know this sounds pretty basic, but investors tend to forget this stuff. No bull market goes straight up, no matter how good the story. So even though commodities, oil and gold are cornerstones of our portfolios, we expect to see them bounce around quite a bit. That doesn't change the fundamentals of their increasing demand and limited supply scenario though. Long term is still up.

Third, this is why you have professional management. We don't get caught up in the emotions of the day. We stay focused on the long term and we question everything.

And lastly, this is why our investment style and strategy is not mainstream or like Wall Street's.

We do not hail the Fed's plans as a panacea. We see the long term damage it does. We are not tied to only stocks and bonds. Instead we have broadened our scope of investment choices to include commodities, international equities and market hedges that are in or entering bull markets.

We continue to focus on fundamentals, not short term market moves.

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