TSG Weekly Market Watch January 16, 2009

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TSG Stock Market Letter Week Ending January 16, 2009 Topics Discussed This Week:

I’ll gladly fix it Tuesday… Leaders outperform but still lose Q4 earnings – Rough ride gets rougher Trillion-dollar Treasury travails New Deal déjà vu

INDEX	Jan 16-09	Jan 9-09	Change	Change%
INDU	8,281.22	8,599.18	-317.96	-3.70%
DJT	3,147.60	3,460.71	-313.11	-9.05%
SPX	850.12	890.35	-40.23	-4.52%
COMPX	1,529.33	1,571.59	-42.26	-2.69%
RUT	466.45	481.30	-14.85	-3.09%
EEM	23.25	24.88	-1.63	-6.55%

Last week

INDEX	Jan 9-09	Jan2-09	Change	Change%
INDU	8,599.18	9,034.69	-435.51	-4.82%
DJT	3,460.71	3,651.02	-190.31	-5.21%
SPX	890.35	931.80	-41.45	-4.45%
COMPX	1,571.59	1,632.21	-60.62	-3.71%
RUT	481.30	505.84	-24.54	-4.85%
EEM	24.88	26.16	-1.28	-4.89%

Quote of the week “We have tried spending money. We are spending more than we have ever spent before and it does not work. . . . After eight years of this Administration we have just as much unemployment as when we started. . . . And an enormous debt to boot!” – 1939 diary entry by FDR’s Treasury Secretary Henry Morgenthau on Roosevelt’s New Deal economic policies. I’ll gladly fix it Tuesday, if you'll just give me another $1 trillion today… It was another turbulent week, spurred on by options expiration as markets continued to be buffeted by bad economic news. Oil and stocks dropped in unison again this week which is just one more concern. And after a good start to the year, the S&P500 is now down nearly 6% since 2009 began. I’d originally planned to add a little levity with the quote that appears at the end of the newsletter but then came across a very interesting article that appeared in the Wall Street Journal by Mark Levey with the quote you see above. I discuss it in detail in this week’s Synopsis which is especially significant given the new management taking over the Oval Office Tuesday. Technically Speaking Leaders lead but still lose ground This week Dan’s portfolio of stocks again included Hess Corp (HES), First Solar (FSLR), Holders Oil Serv (OIH), and added to the list was Potash Corp (POT), Monsanto (MON), CF Industries (CF), Simon Property (SM), Vision China (VISN) as well as three contra ETFs, ProShares UltraShort Financials (SKF), ProShares UltraShort EAF (EFU) and ProShares UltraShort Real Estate (SRS) showing that Zanger was clearly expecting more downside. The strategy seems to have worked; his pix again led the market except this week they lost ground. But the fact that they again outperformed hasn’t proven to be very bullish in the last few weeks. Figure 1 – Five-day performance of Zanger’s last Sunday pix (green) compared to the S&P500 (SPX), the Dow Jones Industrial Average (DJX), Dow Transports (DTX), Nasdaq Composite (IXIC), Russell 2000 (RUT) and MSCI Emerging Market ETF (EEM). Data courtesy of The Zanger Report, performance chart courtesy of VectorVest.com. Weekly volumes moved back above average for the major indexes but the fact that this occurred on falling prices is bearish. Rising volumes on falling prices shows more sellers entering the markets and that is not good news. Similarly, rising prices on falling volumes shows fewer buyers entering the market and that spells trouble in a rally. However, major support levels continue to hold for the time being and prices for the Dow Industrials, Nasdaq and NYSE closed well off their weekly lows and that is also good news. Rising prices need to be accompanied by rising volume if this rally is to resume and have any staying power. After peaking above 80 November 20 then falling through the first week of the year, the Market Volatility Index (VIX) jumped back above 50 again this week before settling to close at 46.11. The 52-week moving average is 33.81 showing that fear is back above usual in this year of record high volatility. After surging over the last five weeks, the 19 commodity NYFE CRB Index dropped this week to close at 360.06 down from 372.90 last week but above the 351.81 it closed at four weeks ago. Since hitting a high of 611.51 in July then losing nearly 50%, the CRB Index has pared its loss to 40% from its peak. Gold slipped for the third week in a row closing at $840.70/oz. off from $854.70 last week. Although we are still in a deflationary period and investors continue to seek a haven in gold, it appears to be in the process of forming a bearish rising flag pattern accompanied with steadily declining volume as is silver. And the prospect of a Democratic President, Senate and Congress and their promises of big spending programs has surprisingly not shaken the faith in the greenback. If anything, it appears to have strengthened it as the U.S. Dollar Index closed higher for the fourth week ending the week at 84.06. This is up from 82.50 last week and 81.10 four weeks ago. Since bottoming in July, the U.S. Dollar Index has gained 17%. After a five month slide followed by a strong rebound two weeks ago, crude slipped again this week to close at $42.27/bbl down from $45.69 last week. Interestingly, volume hit its highest levels on record which could indicate a capitulation point. Oil is down more than 70% from its mid-summer high of $147.20. After falling 75 basis-points in early December, the U.S. bank prime rate and the Fed funds target rate held steady again at 3.25% and 0.00% - 0.25% respectively while the effective Fed funds rate bumped up to 0.19% from 0.13% last week. Meanwhile, the 3-month London Interbank Offered Rate (LIBOR*) slipped again to 1.1425% (From 1.26% last week) (from 1.4125% last week, 2.1856% five weeks ago). This compares to LIBOR 52-week high of 4.81875%. Freddie Mac mortgage rates slipped again to 4.96% (form 5.01% last week and 5.97% six weeks ago) for the 30-year fixed mortgage while the one-year adjustable rate mortgage (ARM) slipped to 4.89% (from 4.95% last week). *LIBOR is the benchmark for $900 billion in subprime mortgage loans which typically adjust to it

every six months. Corporations around the world have the interest rates on roughly $9 trillion in debt pegged to LIBOR and rates on more than $380 trillion in derivative interest rate swaps also are based on LIBOR. About 6 million U.S. mortgages, including the vast majority of subprime home loans as well as 41% of prime ARMs are linked to LIBOR. Earnings Q4 Earnings – A rough ride gets rougher In the second week of Q4-08 reporting season with a total of 435 companies having reported (up from 378 last week), average earnings are now down 60% versus Q4-07, versus off 48% last week. This compares to a drop of 62% for Q3-08 versus Q3-07. Given that earnings have so far experienced their biggest drops since first turning negative in Q3-07 and that results have deteriorated as reporting seasons have progressed, we expect results to continue to deteriorate as more companies report. Economic Reports Trillion-dollar Treasury travails There was lots of news on the economic front this week but not much was of any practical trading or investment value. On the positive side, the U.S. trade deficit shrank to just $40.4 billion in December (from -$56.7 billion November) which is the lowest level in a many years and inflation hit the lowest level since 1954. Unfortunately both are due to a rapidly declining economy so are a mixed blessing. This week’s Beige Book report from the Fed, other than confirming what we already know about the economy, was of little real value to traders or investors. But the most useful report was U.S. Treasury net capital flows, the amount invested globally each month by foreigners, which fell to $56.8 billion in November down from a spike the previous month of $260.6 billion (revised down from $286.3 billion). This spike was the result of a flight to perceived quality amid the credit crisis but the big drops suggests this demand has fallen significantly. Since 2005, Treasury international capital flows have averaged $63.5 billion per month which has been more than enough to finance past budget deficits including that in 2008 which is expected to come in around $450 billion or $37.5 billion per month. However, since initial estimates put the 2009 deficit around $1.2 trillion not including any new spending initiatives by Obama, means that the sale of Treasuries to finance the deficit will need to grow to at least $100 billion per month. Add the latest stimulus package of another roughly $1 trillion and the realistic estimate for the 2009 deficit swells to approximately $2.2 trillion which translates to a need of $183 billion in Treasuries per month just to pay the bills on Capital Hill. The yellow dashed line on the above chart shows $100 billion required using the original estimate. Also note that the net sale of Treasures has been trending lower (orange solid line). Takeaway – even though the necessity for cash to finance Washington’s latest spending spree is skyrocketing, the appetite of foreigners to finance this debt is falling. Not a pretty situation to say the least. Synopsis New Deal déjà vu Our quote of the week above appeared in an excellent WSJ article entitled Leave the New Deal in the History Books by Mark Levey this week that discussed the situation that faces the new President and takes a look back to the last time we faced this degree of financial challenges. As well as reveal the diary entry from then Treasury Secretary, Levey makes some other, rather sobering points. “When Barack Obama takes office on Tuesday, his first order of business will be a stimulus package estimated to be close to $1 trillion, including $300 million in tax cuts and the largest new government spending program for infrastructure since Franklin Delano Roosevelt. Sages nod that replicating aspects of FDR's New Deal will help pull the country out of a recession. But the experience under FDR largely provides a cautionary tale.” “Mr. Obama's policy plans are driven by the conventional economic wisdom that the New Deal economic programs ended the Great Depression. Not so. In fact, thanks to New Deal policies and programs, the U.S. economy faltered for years longer than it might otherwise have done.” Here are some bullet points from his short but powerful history lesson. When Roosevelt took office, unemployment hit nearly 25% and within his first 100 days in office, he created “an alphabet soup of new agencies that mandated actions or controlled public spending and impacted private capital flow.” At first his New Deal appeared to be working as unemployment slipped to 14.3% but then the country entered a second depression in 1937 with unemployment soaring back to 19% in 1938. FDR’s New Deal spending programs were compounded by a spate of new taxes “that crushed the innovation, risk taking, and growth plans of entrepreneurs, corporations and investors.” In the decade following the initial stock meltdown in 1929-30, the top marginal income-tax rate was pushed from 25 to 79%, corporate income-tax rate doubled from 12 to 24%, an excess profits tax and undistributed profits taxes piled on plus a dividends excise tax and a new 2% Social Security payroll tax. This Levey says, “forced the allocation of money away from the private sector.” “As economist Henry Hazlitt wrote back in 1946, New Deal programs prevented the creation of the types of jobs which have the multiplier effect of successful businesses.” Levey is certainly right about one thing, the quickest way to strengthen the financial system and begin to ease the credit crisis is to put money to work in real job creation not into government works programs. And the way to do that is not increase taxes but to slash them. His idea of cutting corporate taxes from the highest in the world to zero may be more controversial but it would put greater capital flows into the “hands of those who are driven to build businesses instead of pushing that capital through a government pipeline with endless amounts of friction.” Either way however, deficits and debt levels will soar. Unfortunately, based on what is happening on Capital Hill, the chances of this approach being taken any time soon are slim to none. It is equally likely that the New Deal approach to fixing our economy is a lesson we will probably have to again learn the hard way. Problem is we (hopefully) won’t have a world war to get us out of the mess. Stories of interest this week… Leave the New Deal in the History Books (Wall Street Journal)
http://online.wsj.com/article/SB123215398370892313.html (WSJ Subscribers)
http://online.wsj.com/article/SB123215398370892313-email.html (Non-WSJ Subscribers) Or try http://tinyurl.com/7h4eq4
Same Old New Deal?
http://www.washingtonpost.com/wp-dyn/content/article/2008/11/28/AR2008112802370.html Capitalism Freezes in Worldwide Winter of Discontent
http://www.bloomberg.com/apps/news?pid=20601109&sid=ai1qca78_ezs&refer=exclusive Obama Bank Rescue May Make New Effort to Resolve Toxic Assets
http://www.bloomberg.com/apps/news?pid=20601087&sid=aLhoVoTkRLTE&refer=home 21,000 Jobs Worldwide Erased in Day as Recession Chokes Demand

http://www.bloomberg.com/apps/news?pid=20601087&sid=aJA3rhYFkThw&refer=home Freddie Eviction Plans Continue During Moratorium
http://www.bloomberg.com/apps/news?pid=20601109&sid=ae1AV9etKrm4&refer=exclusive Dow May Fall to 6,000 Should Low Break http://www.bloomberg.com/apps/news?pid=20601213&sid=a70_dt3j1Nk4&refer=invest Why Keynes is the Wrong Model for the Current Economic Crisis
http://johnfenzel.typepad.com/john_fenzels_blog/2008/11/why-keynes-is-the-wrong-model-for-the-current-economic-crisis.html

"If everything seems to be coming your way, you're probably in the wrong lane." — Borstelmann's Rule

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