

Market Outlook Update

Since the start of the year, we have advised our readers to avoid stocks and stay in cash.

Good advice. Year to date, the Nasdaq is down 13.4% and the S&P 500 is down 6.2%. Even the Dow, which recently has been the strongest of the three major averages, finally moved into negative territory for the year, dropping below the psychologically-significant (if nothing else) 10,000 mark.

One of the primary reasons for our continuing bearishness has been the abundance of optimism among economists and professional market forecasters, which began to manifest itself late last year and has only grown stronger during the first quarter of this year. The speed with which this optimistic outlook has become consensus opinion explains why stocks have been unable to move higher in spite of the profusion of strong economic data; by the time everyone agrees on something, that something is already "priced in." Hence the old Wall Street cliché, "buy the rumor, sell the news."

Witness last Friday (April 26). The Commerce Department reported that the U.S. economy grew at a blistering 5.8% annual rate in the first quarter of this year. The strong GDP number supported the consensus opinion that the U.S. has pulled out of the recession that began in March 2001, and the media reminded us that the recent economic downturn will probably be regarded as the mildest in history.

Rather than celebrating the good news, investors dumped stocks. The Dow dropped 124 points, and the Nasdaq fell nearly 3% to its lowest level since October of last year. Stepping back to look at the big picture, we see that the stock market is weaker than in any economic recovery since the 1970s. Not encouraging.

As we observed in the postscript of our previous letter, "In a situation like this, ask yourself who is more worthy of your trust: the media or the markets? The former gives you hype and hysteria; the latter delivers efficient pricing of all known information... Our guess is that there will come a time, possibly later this year, when we see the reverse: the media will become increasingly pessimistic while the markets rise in the face of bad news. That will be the time to buy."

Rest assured, this bear market will end and a new bull market will begin, but not when most people are expecting it. So our outlook for the U.S. equity markets remains negative, and we continue to recommend holding cash in anticipation of a compelling buying opportunity.

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PS – Reader Steve Friar writes in response to our last newsletter (March 31), "My only comment is that it reads like a Gore Vidal novel... I had to think way to hard to get the information I needed. I do not know who your target market is, but for me (I went to a state school) it was too much work." Although we like Gore Vidal and were flattered by the comparison, Steve's point is well taken (and we have heard rumors that he is not alone among our readers in feeling this way). We hope that this get-to-the-point one-pager will be a welcome respite from the long-drawn-out and long-winded newsletters of the past. In the future, look for us to experiment with the design of our letters to make it easier to glean the key points without abandoning the writing style that many of you seem to enjoy.