Market Commentary
Second Quarter 2009

The Market

The stock market having reached a more than ten-year low on March 9th, the market rallied strongly out of one of the most oversold markets I had ever witnessed in my lifetime. That rally phase saw the market, as measured by the S&P 500 index, reach a rally peak of 929 on May 8th. The rally moved the S&P index 39% out of the early March low and had the effect of bringing the S&P 500 to about a 3% gain for the year, thereby recouping all of the steep losses incurred in January and February.

The upward-sloping steepness and speed of the rally had the effect of quickly moving technical indicators into an extreme overbought condition, arguing for a corrective phase to begin at any time following the May 8th high reading. But market tops very often take on a different personality than do market bottoms. Market bottoms are often made out of "spike" bottoms (the March 9th was a classic example of a "spike" bottom), whereas tops often take more time to unfold. Very rarely are stock market tops identified by a perpendicular move up.

The corrective action since May 8th has taken the form of a rounded top defined as a gradual deterioration of price appreciation followed by a gradual acceleration in price downward. I have to say that the corrective action since May 8th has been barely perceptible in terms of price since the S&P 500 has declined by less than 2% since early May, while market internal technical indicators have worked off extreme overbought readings and currently stand as being collectively neutral. In other words, technical indicators have worked off the May 9th overbought condition, while price has not yet suffered to any serious extent. It could very well be that price rapidly catches up with market internals as the market works itself into a bullish "oversold" condition.

Conclusion: The market is still in a corrective phase that began in early May, but the correction has manifested itself in a generally "sideways" move while market internals correct to oversold levels, presumably paving the way for another upleg. It could take a while to get there in terms of time, and it's, perhaps, in the cards that price eventually catches up to the market internal; but I think any market weakness in the weeks and months ahead should be used to add to positions.

US Treasury Bonds

The price of US Treasury Bonds has fallen sharply so far this year, with the yield on the 30-year Treasury Bond having risen from its December all time low of 2.55% to 4.85% in May - since backing off to 4.3% at quarter's end. While acknowledging that yields will not rise every day, every week, or every month, the supply/demand relationship between debt, contemplated to be issued by the US government, as compared to the quantity of buyers for this debt, is overwhelming in favor of higher interest rates for Treasuries, and therefore lower prices for long-dated Treasury bonds.

The Price of Oil and Energy

The price of oil continues to remain strong as the second quarter comes to a close, with oil having risen to $70 per barrel, more than double the $30 per barrel price realized earlier in the year. While commentator after commentator tells you that oil should not be at $70 per barrel, I can only tell you that it is and that an uptrend is in place. Energy alternatives, such as wind and solar, do not effectively compete with oil at prices less than $80 per barrel, and even then these alternatives are subsidized by tax credits. Plus, the combined forces of natural declines in the world's largest oil fields and lack of new supplies being found, add up to higher – potentially substantially higher - prices in the years ahead. While our politicians orate about the great prospects for wind and solar, they should be reminded that wind currently accounts for less than 2% of electricity production in this country and has only a 10-15% capability many years out – hardly a meaningful effect now or in the future.

Terminology

Just as I think that "buy-and-hold for the long-term" is the most dangerous way an investor can think, I think the terms "bull market" and "bear market" also have potentially negative consequences for the investor.

Here's why: Many people, when they hear the word bullish or bearish, immediately think in terms of what the market is going to do for a long time period. Well-defined trends (up or down) do not occur very often - perhaps once in about 2 or 3 years. We just had a well defined downtrend that lasted for about 17 months. But most of the time, the market contains many well-defined trends which may last for comparatively short periods of time. The rally off of the March low is a good example of a well-defined uptrend that lasted for 8 weeks.

I would prefer the use of the terms "upward trend", "downward trend", and 'sideways trend', because these terms fully express what is going on at that specific point in time. Moreover, if you make a uptrending market commitment, and then a few weeks later, perhaps because of changing fundamental conditions, you come to the conclusion that the market is heading down, you will find it much easier to accept a trend reversal than if you had a confirmed opinion that the market was definitely in a "bullish" or "bearish" mode. I'm actively seeking to find a good exorcist that will help me drive all of these dangerous terms out of my mind!

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