



Market Commentary October 2010

“Riding the Rollercoaster Back to Where We Started”

September 2010's 8.6% total return for the S&P 500 was one of the greatest returns for the month of September in U.S. History. Even with this Herculean effort, the Market is up less than 4% for the year. 2010 could go down in history as “The Year of the Rollercoaster!” I am in awe of the Street's unconstrained desire to force the Market higher. The problem is that their efforts have little fundamental support. The economy is NOT cooperating with the Street's argument for higher returns. More than 1 in 10 Americans celebrated the official end of the recession while standing in the unemployment line. Uncertainty is everywhere. If you have a job, you know someone who has lost theirs. Credit is still only available to those that do not need it. Congress is up for grabs in November and the administration seems determined to keep their plans for small business legislation as secret as possible.

As the economic headwinds continue to build against the Market, valuation argues that stocks are over-priced! With the exception of a couple of well known “bubble periods,” a great deal of the Markets total return to investors has come in the form of dividends. Dividends have always been a major source of portfolio growth. Therefore, valuing the Market based on dividend yield is both logical and necessary for the individual investor. Unfortunately, the current dividend yield for the S&P 500 index is below the historic average. As a matter of fact, if you exclude the 10 years from 1997 to 2007, dividend yield has only fallen below 2.5% THREE times! The median dividend yield (again excluding the 10 year period mentioned above) is over 4%! What's the dividend yield today? LESS THAN 2%! I know that there are critics out there that will argue that the dividend yield is less important today because of the incredibly low interest rates currently offered. To me, this argument smells a whole lot like the dreaded “This time is different” argument that is heard at most market tops! In late 1999 we were told that dividends don't matter and they are only paid by companies without growth potential. The theory held that “growth companies” should NOT pay dividends but, rather, should reinvest every penny possible. That theory didn't hold much water by the summer of 2000!

So what to do now? Most U.S. stocks are overvalued. Bonds yields are at historically low levels. There is NO inflation to be found but oil is hovering over \$80 per barrel. The home foreclosure rate will be delayed by recent overreactions but will continue to hurt the buying power of average Americans. Europe is still in better shape than we are but that is just a relative argument. And the awkward tandem of U.S. Treasuries and Gold continue to reach all time records! As I have said before, these two sectors make very strange bedfellows and continue to point to one thing: Fear!

My take on what to do is to wait for a pull back and then add to opportunistic areas. Technology will continue to be an industry in demand. Companies are still scared to hire full time workers and will continue to invest in technology in order to put off hiring. This is good for Intel and Cisco, but not good for the housing market or the auto industry! Emerging Markets are growing richer and their citizens are buying. This might help our manufacturing industry but I seriously doubt it. It will help the manufacturing industries in these growing countries that focus on selling to their own rather than selling to America! In addition, foreign bonds continue to look attractive. For better or worse, the Federal Reserve is going to blindly throw more money at the problem by engaging in another round of Quantitative Easing (QE)! This sure seems like giving the starving U.S. economy a fish rather than teaching it how to fish!

In conclusion, CASH IS KING! I know that earning basically nothing in a money market fund is frustrating. But losing a big chunk of your assets because you ran out of patience is a great deal more frustrating. Keep a long term prospective and wait for an opportunity to INVEST for the long run rather than gambling on the monthly momentum of the Market. You'll sleep better at night and your capital will be there if you need it.

As always, your questions or comments are welcome.

All the best, Rob

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