



Market Commentary January 2010

“Tip Toeing Higher without Anyone Noticing”

The S&P 500 Index has continued its move higher so far in 2010. However, the advance has slowed down, trading volume has evaporated, and the traders who are trading have become extremely complacent! This combination is very unsettling as it indicates that the large institutions are not “buying the hype” and staying on the sidelines. One could argue that once they do start buying, the market will go up faster. Somehow I don’t believe that. I think a market with low trading volume and low volatility (as measured by the VIX – the Chicago Board Options Exchange Volatility Index) is just looking for an excuse to correct!

I can identify many structural headwinds that will do nicely as an excuse but I have no idea which one will be recognized by the market or if some other reason will instigate the correction. The challenges facing the market in my view are as follows; the disconnect between the stock market and the economy, the structural weakness of the U.S. Dollar due to the mountain of debt issued by our government, the associated inflation potential due to the dollar weakness, an unemployment rate that will stay stubbornly high for a long period of time, and the very real risk of the wheels coming off the Chinese economy. I won’t touch on all of these topics as many of them have been of concern for quite a while and mentioned in past commentaries. The two that I will discuss this month are U.S. unemployment and China.

According to this week’s edition of The Economist, there seems to be little hope of escape from a truly jobless recovery, given the dismal rate of job creation in the U.S. **The population grew by almost 30 million between December 1999 and December 2009, but at the end of that period, only 400,000 more Americans had jobs.** The Economist goes on to say that “without job growth, household indebtedness will linger as a problem, depressing spending and hiring. Joblessness is a trap the American *labour* force may not soon escape.” To me, this screams of the “U” shaped recovery that we have been talking about for months. When hope is climbing higher but reality is closer to flatlining, a disconnection is generated between the stock market and the real economy.

On the China front, many skeptics thought that the U.S. recession would pull China down with it. They were proved wrong (at least so far). China has decoupled themselves from the U.S. consumer and is now succeeding without us. However, success brings its own challenges. The Chinese government is now trying to slow down their economy. As we have seen time and again with our own Federal Reserve, letting the air out of a bubble without popping it is not an easy task. My concern is that our FOMC Committee has been trying to do this for decades with poor to moderate results. Can we really expect a government with no practical experience being able to pull this off on their first try? The odds are against them.

So does this mean that we should bury all our money in mason jars? NO! It just means that there are times to allocate resources to domestic equities and times to overweight other investments. There are plenty of areas that should be over allocated but your timing is critical. In the domestic market, there will be a buying opportunity and my guess is that it will come sooner rather than later. Once the correction comes, I would favor technology companies over all others. With all the uncertainties about taxes and labor laws, businesses will invest in their technology in order to avoid hiring people! Outside of technology, I would lean towards large companies that have stable revenue and the ability to pay dividends. These companies have cut as much fat as possible during the recession while hoarding cash. As most of you know, the investment banks made a fortune last quarter and a large chunk of that was centered on fixed income issuances. Large domestic companies are issuing bonds like crazy. Why? Because they can! Rates are low and demand is high for quality bonds. The question is what these companies will do with all this cash. Do they need it to survive? No. If they did, no one would have bought their bonds. As stated above, big business will invest some of their new cash in technology and hoard the rest of it for later. I believe that you will see mergers and acquisitions pick up later this year and into 2011 and the acquirers are preparing their balance sheets now for a buying spree later.

Outside the United States, I like major manufacturing countries, such as Germany, countries with vast natural resources (Australia and Norway), and developing countries with young populations and governments that promote advancement (India and Brazil). These countries should be the winners during the next few years. The real question is how best to invest in them. For that, contact me directly.

Leaving the market behind, January is always a time of personal resolutions. For me, the word resolution insinuates too much wiggle room. Instead, I create a list of financial tasks each January. Tasks are easy to review, complete and check off. Here is a sample of a financial task list that all of us should put in place:

1. Start or increase 529 plans for your children.
2. Contribute to an IRA.
3. Review your asset allocation – Can you take another hit like you did in 2008?
4. Start or increase an Automatic Investment Plan.
5. Organize the data needed for your tax preparer.
6. Review insurance plans – Too little? Too much? Umbrella policy?
7. Review all automatic debit plans.
8. Create a charitable donation budget based on last year's donations.

I hope this list helps you create your own financial to do list. Once created, make sure you check off your accomplishments.

As always, feel free to contact me with any questions or comments.

Happy New Year,

Rob Green

Robert B Green Jr, CFA
President
Cojo Bay Advisors
(510) 384-223
rgreen@cojobay.com