Monday, March 13, 2006

MARKET WATCH

A Sampling of Advisory Opinion

Edited by ANITA PELTONEN

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Growth's Busting Out All Over
Be More Venturesome by Moneyletter / PRI Financial Publishing
479 Washington St., Holliston, Mass. 01746
March 10: The market lately has had a bad case of the interest-rate jitters. Central banks around the world, with the exception of the U.K., have either raised rates recently (European Bank, U.S. Federal Reserve) or threatened to raise rates (Japan). While the actions by the central banks are uncoordinated, there is a reason for higher global short-term rates, namely, the global economy is thriving. Growth is busting out all over....

We believe the Fed is close to being done. We also believe that the U.S. market represents good value at current prices, even if the 10-year Treasury were to settle at 5%. Inflation is always a threat, but the odds still favor a low-inflation outlook.

-- Walter Frank

Inflation Nation
Outlook for Financial Markets by Harris Private Bank
111 W. Monroe St., Chicago, Ill. 60603
March/April: Inflation is perking up as pricing power appears to be gaining strength. Producer prices of finished goods are expanding at a 5.7% rate year-over-year through January. Much of the advance can be attributed to automobile-price hikes, as well as advances in capital equipment prices.

The labor market, while late to the party, is beginning to tighten. Strong employment gains last month added to the close to 700,000 jobs created in the last three months. Hourly wages gained 3.3%, rising at the fastest pace in nearly three years. Adding to the disturbing trend, productivity, the rate at which output per employee improves, is slowing.

Productivity gains can effectively negate wage gains by restraining output costs. Productivity growth has outpaced wage growth for much of the last four years. Recently, this trend has reversed. Productivity in the fourth quarter fell at a 0.6% annual rate from its 3Q level, putting productivity behind wage growth

for three consecutive months. Perhaps we are nearing an end to corporate cost-cutting. Now, many firms will be forced to raise prices to keep earnings growth on track....

Looking forward, only 13.4% of Americans polled felt that better employment opportunities lie ahead....The U.S. stock market is off to its best January and February in years...[yet] there's still plenty of turbulence underneath the surface, making it difficult to track trends. Last time volatility was this low was right before [Long Term Capital Management's blowup]. Risk doesn't matter until it matters.

-- Jack Ablin

Exit North

A.M. Notes by BMO Nesbitt Burns

1 First Canadian Place, Toronto, Ontario M5X 1H3 Canada

March 8: The Bank of Canada continues to gradually turn down the volume on future rate-hike expectations, sending a moderately more dovish signal following [the recent] quarter-point hike to 3.75%. The key word this time was "may," leaving the bank with an out if the currency flares higher again for no particular reason....We continue to believe they will hike again in April to 4%, and then stand aside and see how the economy responds....

More notes: According to the U.S. Treasury, the average tax refund given to taxpayers this year is up 4.6% year-over-year, to $2,480. That is a light tailwind for consumers, but it will help consumer spending, nonetheless. Maybe many of those will use some of their refund to pick up a copy of former Fed Chairman Greenspan's memoirs when they are released in the fall of 2007 (he wrangled an $8.5 million book deal.)

-- Jennifer Lee, Douglas Porter, Benjamin Reitzes

Seeds for Bond Rally Planted

TIPS Send Key Signal by Miller Tabak

331 Madison Ave., New York, N.Y. 10017

March 8: The yield spread between 10-year inflation-indexed Treasuries and conventional 10-year Treasuries is narrower [as of Wednesday], and has been falling sharply over the past few days in concert with the worldwide decline in commodity prices. At 2.53%, the yield spread is down 4.5 basis points from yesterday's level and 9 basis points below [the previous] Friday's peak, which was the highest since last April. [A basis point is a hundredth of a percentage point.]

The spread, which reflects market expectations for the consumer-price index over the next 10 years, was as low as 2.29% at the end of December, but had been creeping upward due to continued gains in commodity prices, as well as signs of strong economic growth. Rising global interest rates have been taking their toll on commodities.

-- Anthony Crescenzi

NewSpeak Makes Him Freak

The Mogambo Guru

9241 54th St. N., Pinellas Park, Fla. 33782

March 8: What a scam! The week [before last], the Fed snaps its fingers and creates $2.2 billion, and then uses it to buy $2.2 billion in government debt! What in the hell can you do but laugh at the sheer audacity! Somehow, a government creating more and more money and spending it is not, for the first time in history, going to turn out to be a bad thing? And especially one where the money is just paper and computer blips that they can create on a whim?

Of course, I sigh wearily as I note that the banks themselves are in on the scam, and they bought up another $13 billion in government debt [the week before last]. Foreign central banks continue to soak up government debt, and they swallowed another $7.6 billion [that] week, too.

But all that economic fraud is getting to be old hat by this time. What is tragically new is that if you are familiar with the George Orwell novel 1984, then you are familiar with concepts such as NewSpeak and NewThink, which are twisted lies and frauds with the authority of law. Along those same lines comes, except in real life and not in some terrifying novel of a fascist government gone berserk, is the idea of NewBank [a backup bond-clearing bank for clearing and settling U.S. government securities]...because this is monetary corruption at its absolute worst!

The government sells debt to get money to spend on its deficits, and the bank creates the money to buy the debt. Debt and money supply both expand, and it expands to create a bigger and more expensive government! And higher prices. This is economic suicide!...

I think there was a Monty Python sketch where the guy, incredulous at being told something preposterous, sticks out his leg and says "Go on! Pull the other one!"

-- Richard Daughty

Defense! Defense!

Advisory Research by Structural Logic

30 S. Wacker, Chicago, Ill. 60606

March 8: 'Tis a good time to be defensive in the U.S. stock market when 10-year yields are spiking above 4.75%, coupled with central bankers around the world raising rates, and when the market leadership vis-à-vis oil services and energy sectors [is] plunging in response to the Iran premium being sucked out of the crude-oil market.

Even the tech sector is at risk, due to lowered guidance from market leaders Intel and Texas Instruments this past week. While you may not want to sell equities quite yet, at best the S&P 500 is a shaky hold, near-term.

-- John Bougearel

Correction Reflection

Are We Having a Correction? by Valuestockpicks.com

4032 Crandall Circ., Santa Clara, Calif. 95054

March 8: Are we having a small correction in the U.S. stock market? Clearly, yes, we are...The reason seems to be higher interest rates and simple overvaluation of stocks. Let's look at how much the indexes are off their highs that were set in the last two weeks: Dow 30 Industrials, - 1.92%; Standard & Poor's 500, -1.77%; S&P 400 Mid-Cap, -3.3%; S&P 600 Small-Cap, -3.45%; Russell 2000 (All-Cap), -3.53%; Nasdaq Composite, -3.3%; Value Stock Tips Model Portfolio, -3.24%.

Whenever there is a correction, you want to compare how much your portfolio is down, versus the market overall. That will give you an idea how much of your performance is attributable to your stock-picking and how much is the overall market going up or down. While disappointed, I'm pleased the model portfolio is performing in line with the market, after getting whacked on AMD [Advanced Micro Devices] and PALM [Palm], back to back. Some mistakes I have made recently included not taking profits on CSX [CSX Corp.], CAT [Caterpillar], and JEF [Jefferies Group]. I could easily have locked in 5% profit gains, and now be buying them back and re-entering the positions. After the large run-up since last October's bottom, until we get resolution on the interest-rate question, this will still be a trading range market.

The way you can tell when you need to take some profits is when you sense that your specific stocks are ahead of themselves -- trust your instincts and take some profits. Last year, by constantly...selling and taking profits on one-third or one-half of a position, then buying back on a pullback and repeating the process, I racked up 31.5% in gains, trouncing the market. Most importantly, when you look at a list of stocks that you follow and you say "I would only buy three out of 103 stocks," the market is ahead of itself and will probably inevitably correct....

Don't let the Wall Street consensus about higher interest rates shake you out of the market right now. The only sectors that I feel are unattractive are momentum sectors like technology and commodity stocks. Technology [firms are] pretty clearly going to have light revenue and earnings for this quarter across the board, and are still overvalued. In 1994, commodity stocks were all the rage until all major countries were raising interest rates, and they just got crushed.

-- Mark Thomas

End Game vs. Halftime

Update by Daily Market Clues

P.O. Box 150249, Austin, Texas 78715

March 7: Stocks are in the same position they were in back in early 1994. The bond market came unglued, sending the big stock rally, which saw the broad market soar 118% from its October 1990 low to its March 1994 high, plunging into a steep, but thankfully brief, correction into summer. Stocks have gained just about that much since the 2002-'03 lows, so the comparison seems realistic....It wasn't pretty for bond investors in 1994. This one could end up being even worse.

-- Bob Carver

Watch the Wedge

Spring Break by Nollenberger Capital Partners

101 California St., San Francisco, Calif. 94111

March 7: Business news seems mostly positive and investor psychology mostly complacent; neither is

out of place for a top. As for speculation, it's overseas, where international markets, led by India, are in a parabolic price rise. The U.S. market is the laggard, but [as] we're also the engine, it's difficult to imagine foreign markets rising if U.S. stocks head lower.

The S&P 500 (SPX) rallied Monday, Feb. 27, to a new cyclical high, but there was no follow-through, which has been typical of market action so far in 2006. That Friday [March 3] -- the key harmonic day we were tracking as a likely turning point -- the SPX approached its Monday high, missed by 0.24 of a point, and faded.

[Despite some possible] short-term weakness, net volume readings remain in gear with the uptrend. Still, we think the backdrop calls for caution. Peak net volume readings have declined with each rally since the April 2005 low; it wouldn't take much selling to overbalance.

Longer-term, the SPX looks to be in a wedge-shaped pattern from the October 2004 low. If the SPX reverses and breaks from here, these patterns are typically followed by rapid A-B-C declines to the start of the wedge pattern. If our bias is confirmed, the good news is that any decline following this pattern would most likely mark a correction, and not the start of a more serious bear market.

-- William Gibson

Capex Shifts Shape

A New Paradigm for CapEx? by ING Investment Weekly

10 State House Sq., Hartford, Conn. 06103

March 6: Some analysts speculate that we're in the early stages of a capital-expenditure boom...citing the plethora of cash on corporate balance sheets, rising capacity utilization and recent spending below the long-term trend level. We're not convinced these factors are sufficient to support a near-term boom. We expect capex to grow along with the economy, [but] do not expect growth rates to rebound to historical levels...[as] new technologies provide relatively low-cost opportunities to increase capacity....

It is also likely that have extended the concept of just-in-time inventory-management concept to just-in-time capital investment.Globalization has exert[ed] downward pressure on U.S. capex. While domestic capacity utilization has been increasing, it appears that there is excess capacity globally -- the result of several factors, including the mercantilist growth policies of some emerging economies, cheap labor and high savings rates outside the U.S.

This global excess capacity limits domestic capital spending by providing low-cost offshoring opportunities; a company might close domestic plants and shift production to a lower-cost country....

Another factor limiting capital expenditure growth: deflation...Companies are getting more bang for their capex buck, and the useful life of this capital is increasing. While many will claim that capex must increase in order for our economy to maintain its earning power, they are overlooking the fact that investment dollars have been redirected from physical assets to intangible assets. Companies are increasing spending in areas such as research and development, and employee education.

-- Ken Hockstein

As (War) Deficit Spending Fuels Inflation...

Growing Global Anxiety and Markets by the Aden Forecast

P.O. Box 790260, St. Louis, Mo. 63179

March: The war in Iraq is now costing more than the Vietnam war, per month, adjusted for inflation. Plus, the U.S. has already spent almost as much as it did in Vietnam, even though that war lasted 13 years. The U.S., however, can't afford it. So it's cutting social spending,

Medicare and other programs as it pours more money into military spending, which will be nearly a half - trillion dollars in the year ahead. It's also creating money out of thin air to cover these expenses and that's why the budget deficit keeps hitting new all-time highs....

All of this deficit spending and booming money supply is also fueling inflation...Producer prices recently rose 7.2%, annualized. The latest figures showed the biggest gain in core prices in a year, while consumer prices surged at an annual 8.4%.

A loose money supply is the cause and price inflation is the effect. That's always been the case and it's happening again. And since gold is the ultimate inflation hedge and it reacts to world tension, that's why it's rising, too.

The situation was very similar in the 1960-70s. As the war in Vietnam dragged on, the government adopted a guns-and- butter policy it couldn't afford. Monetary policy was irresponsible, which almost always happens during times of war, result[ing] in soaring inflation in the late '70s. Gold also soared to $850 in early 1980.

We don't think we're exaggerating when we say the situation today is more serious.

Portfolio recommendation: 50% gold, silver-and-gold, silver, energy and natural-resource shares; 50% cash: 35% U.S. T-bills or money-market, 15% Canadian dollars.

-- Mary Anne and Pamela Aden

Strong Without Overheating

2006 Stock Market View

by Harloff Capital Management / Investment Policy Committee

815 Crocker Rd., Westlake, Ohio 44145

1st Quarter: Short-term rates may go higher than consensus, to 5.50% to 5.75%. Money-supply liquidity is strong. The U.S. economy is still strong and growing, and not overheating. Credit risk is in the normal range. The U.S. stock market is undervalued, relative to bonds...[and] should have a gain in 2006.

We find the U.S. economy growing at an average three-year rate of about 3.5% per year. This is a strong increasing rate that is not yet overheating. The Treasury yield curve, from three months to 10 years, has flattened in the last year and is currently slightly inverted. This indicates that no economic growth should prevail for the next several months.

-- Gary Harloff

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