

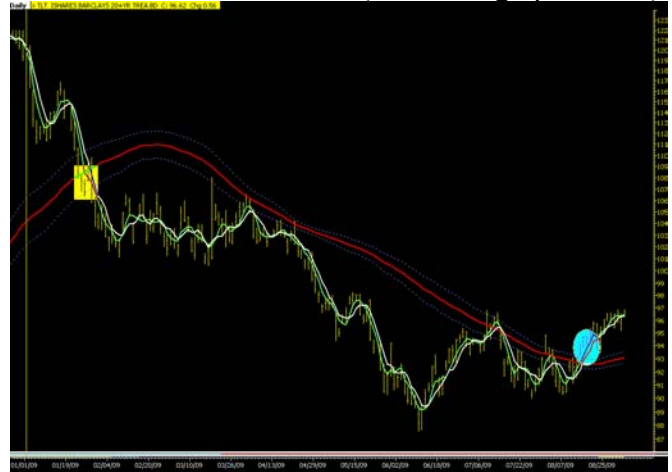


## 5-Month Green Shoots Rally is Ending

**Monthly Outlook: September 2009** In March the global equity markets were pricing in the end of times which didn't come. Then, the tides turned and a spectacular shift occurred as investors feared being left behind and bought stocks on every "green shoots" spin on the news. We quickly bounced from risk-aversion to risk-seeking and any less-bad news was enough to justify the buying. Global equity markets rebounded 40% - 50% in the "Green Shoots Rally" which is not all that unusual for bear market rallies. But now we have likely overshot to the upside as much as we were overdone to the downside in March. Markets have now priced in 4% GDP growth for next year and that is just wishful thinking. Too cold, too hot – the markets can't seem to get it "just right". As we enter September/October, often a weak period for stocks, even "green shoots" aren't good enough to make the markets go higher. Watch now for mildly improving economic and corporate news and the equity markets failing to rally like they used to. Unless companies can actually "show us the money", equity markets are vulnerable over the next couple of months. A 10% to 20% pullback would not only price the market "just right", it would leave the S&P500 at about 850, or -5% for the year. A little boost at year-end, and the markets end up about flat for the year – after a wild ride.

Enough of speculation, that's not really our main focus. We have found it more profitable to respond to whatever the trends are actually doing right now. And as we enter September, there is an important development we want to share with you. Think of the global investment markets as a continuum of risk with US Treasuries on the risk-free end and Emerging Market equities on the other. During the recent Green Shoots Rally, investors threw money at the riskiest of assets – Emerging Markets & related Commodities, Cyclical Stocks, Small Caps, even Home Builders. And they sold US Treasuries. In the middle of the barbell are large Developed Country equities (US / Europe / Japan) and they too rose in

value following the risk-seeking buying spree. As we start September, though, we see cracks in the trends. We now have SELL signals on China, India & the related Commodities. And we have BUY signals on the risk-free US Treasuries (see YTD graph below).



Are the ends of the barbell warning us that a SELL signal for the middle of the barbell (US equities) is coming? That's what we'll find out in September and October and it would dovetail with our "just right" pullback expectations discussed in the first paragraph. For now, the right call is to sell the riskier Emerging Markets & Commodities, buy the US Treasuries, and watch and wait to sell the S&P500 and EAFE.

On the economic front, we're in a bit of a lull. Bernanke has already been re-appointed, the Cash for Clunkers is over, and we're between quarterly corporate earnings reports. Maybe now would be a good time for a Cash for Vacations program? We'll get August jobs report on Friday and we expect job losses but at a slower rate and for the unemployment rate to continue to rise. Housing prices continue to slide (now down about 28% since the peak) but there is activity at the right price. The worst of the recession is likely over but we expect the "new normal" is very slow growth due to de-leveraging and re-regulation. It's not such a bad thing. The markets just have to settle down with less yo-yo action as they get it "just right". It'll happen - soon enough.