

Some Reasons For Market Optimism

by Stephen J. Butler

I would hate to be branded as yet another economic Pollyanna, but I am excited about some of the good things I see out there in the wilderness. For example, my analytical friend, Mike Ridenhour — always ahead of the curve — sent me a titillating blurb about the rise of the Baltic Dry Index a few weeks ago. The what? I'm sure you've never heard of it either, but it doesn't matter. What does matter is that the BDI is something that has doubled in value from its low point a few months ago. And, any indicator going up in these troubled times is a good thing.

The Baltic Dry Index is a measure of the cost of shipping raw materials like iron and cement. It has been around since 1744 and is considered to be one of the most tamper-proof barometers of world commerce. The supply of cargo ships is reasonably inelastic. This means that when demand for shipping heats up, the price for shipping goods goes up. Why? It takes too long to fabricate new ships to increase the supply of shipping. With static supply and increased demand, the only thing that can give is price.

A rising price of world raw materials shipping means that more products are going to be manufactured in the near future. If you look at graphs that show the BDI compared to world economic output, this index is a convincing forward indicator. Right now, it is headed straight up. And, unlike job statistics or other economic data that can be massaged and manipulated, the BDI is an actual price that can be monitored in real time.

Some consider it to be the only indicator worth tracking. Check it out at www.investmentu.com.

Meanwhile, the market may continue to disappoint, but at least it's operating in a more predictable way.

Last year's surprise market collapse took no prisoners. It dragged all types of funds right over a cliff. Even bonds were not spared. The deluge was caused by stricken, hopelessly-leveraged financial institutions having to sell the family farm. Stocks. Bonds. Everything must go! Now, by comparison, there are some types of funds that are starting to break out of the pack and excel against overwhelming odds. Technology funds have gained 2 percent this year while the rest of the market has lost about 10 percent. Health funds are up 3 percent. The last time I looked, Vanguard's REIT Index fund was up 17 percent. This is as it should be.

In every normal stock market crash, there are at least some winners. In 2000-2002, it was the small cap value fund category that starting racking up 20 percent annual gains while the rest of the market swooned. Meanwhile, while even bond funds cratered last year, companies with stellar credit can receive loan proceeds through newly rejuvenated bond markets. Things must be loosening up if I have just refinanced my house with little fanfare at a historically low fixed rate.

What I'm beginning to see is the possibility that the economy will work its way around those "too-big-to-fail" carcasses in the center of the banking industry and find other ways to finance the bulk of our borrowing needs. We can start with the 8,000 regional banks that are, for the most part, solvent and that stand to benefit from a lack of big-bank competition. Talented rainmakers will leave larger banks bringing customers with them. They'll arrive at smaller banks where they can see what it's like to make a difference.

This is not 1982 or anything like the Great Depression. There is no inflation to speak of today.

Moreover, I would say the bottom has arrived in housing when people are paying cash for 20 houses at a clip and renting them out at competitive rates. Young first-time buyers are jumping at the best housing opportunity of the past 15 years.

It's true that unemployment has been rising, but most people still have jobs, and most companies are still making lots of money. And let's not forget China. They are growing by "only" 10 percent, and the Shanghai Index is up 31 percent so far this year. Are we peering into the abyss? Give me a break.



Like A Mosquito In A Nudist Colony

by Stephen J. Butler

*W*hat a great time to be young – and employed. The dichotomy of recessions is that people tend to get increases in pay if they are fortunate enough to avoid layoff. While the world is going to hell in a hand basket, employers may reduce head count, but they are inclined to increase pay for those who stay on and are absorbing more of the workload. When the chips are down, smart employers don't want to lose people they can count on.

In 2008, average pay increased by 4 percent across the country. While the media harp on the large number of the newly unemployed, as a percentage of America's workforce, it is relatively small. "Full employment is defined as the point when only 5 percent of the workforce is unemployed. If we are approaching 10 percent unemployment today, then its only 5 percent above the norm. In other words, 95 percent of those usually employed still have jobs and on average they are making more money.

For young people with jobs, life is better today than it has been in the last five years. For one thing, they can buy homes today for about half of what they might have paid two years ago. Need mortgage money? It's available at historically low interest rates. Stocks and mutual funds? Same thing. Need to splurge just a little? EBay and Craigslist offer a cornucopia of "stuff" at a fraction of what new consumer goods were selling for before the economic crisis. Want to go somewhere? Check out this Travelocity package: I just spent three nights in New York City at a medium-priced hotel, and the round-trip airfare on Jet Blue was free. What's to not like about a combination of pay increases and half-price sales?

So, things are not as bad as they sound. In general, businesses are still making money — just not as much as before. Business owners or managers are preparing for the worst, of course, so they are quick to cut marginal employees in preparation for what might become a downturn that actually impacts them. They're thinking: "even paranoids can have real enemies." The reality is that gross domestic product actually increased over the year in 2008, and the average company made more money last year than they did in 2007.

There are certainly pockets of despair, but only 3 percent of the American workforce is employed in the financial sector. The homebuilding industry employs five times the number of people in the automobile industry, and clearly both industries are hurting. But then, there's everyone else, and for the most part they are working for companies that are having a reasonably good year — considering.

Warren Buffett just pointed out that the economy was in shambles and would be in turmoil for awhile. That didn't mean that stocks were not a good buy, however. Given today's opportunities, he says he feels "like a mosquito in a nudist colony."

Stocks get pummeled, in part, by a new round of redemptions from hedge funds. Investors, spooked by the proliferation of "Ponzi schemes," are suddenly sensitive to the fact most hedge funds just give their clients a simple sheet of paper every quarter saying only what the earnings or losses were. No backup. No nothing. Who knows? But, as Warren Buffett reminds us, "When the tide goes out, you see who's not wearing a bathing suit." I say, "Mix those metaphors and bring on the mosquitoes."

Since October, over \$1 trillion dollars has left an industry of hedge fund wise guys that lost an average of 19 percent — an average that fails to count all those that lost everything and went out of business. What this means to the "little people" like you and me is that the supply of stocks for sale overwhelms the demand and drives down the value. This further disconnects the value of stocks from the intrinsic value of the companies they represent. How disconnected? The dividend alone from General Electric now represents a 15 percent return on the current share price.

Bottom line? It's an opportune time to be young with a lot of investment years ahead. A struggling economy offers a great chance to purchase investments at substantial discounts. Apply a little discipline now, and when the market turns around, you'll feel like a genius.

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