Buy Stocks

16 March 2008
Dow Jones: 11,951

For months we have urged caution in stock investing. Our special study in January suggested that a quick economic fix was not in the cards. Headlined by the Bear Stearns debacle, the investing world is in disarray. Negative emotions and high anxiety are rampant, and the market's distress is creating temporary opportunities for investors. We are selectively buying stocks, and see opportunities ahead.

If read correctly, the market frequently gives clues to the future. Last week was no exception. The dollar has declined significantly, and is presently trading at or near its weakest levels against the Euro and the Japanese Yen. The cheap dollar has helped make our exports increasingly attractive.

Which firms are best poised to take advantage of export opportunities? Sectors such as Industrials, Transportation, and Materials. It is no coincidence that last week the Industrial average actually rose while the broad market was falling. Who takes exports to the market? Transportation firms, these stocks also advanced. How about the materials exporters use? Higher almost across the board!

Credit declines lead to disinflation. The money base, a key component for inflation growth, has changed dramatically. In September 2001 the base was growing at a seasonally adjusted annual rate above 28 percent. Now? It is declining at an annualized -1 percent rate. Further, bank reserves have fallen, and loans are being curtailed in dramatic fashion. All of these constrain credit, which in turn will lead to lower prices. Deflation, now evident in housing prices, will be seen shortly in energy and many commodities. Already, stocks of chemical firms, which benefit from lower oil prices, are rising. Airlines, which must offset massive energy costs, are curtailing hedging against oil price increases.

There is too much pessimism, and stocks are likely to counter this. The ratio of bears to bulls is excessively bearish, with more bears than bulls. This is a rare occurrence, last seen near market bottoms in July to October 2002. Our Risk Exposure Ratio, at a high risk level of 74 in late 2006, is a much more benign 24 today.

By historic comparison, the upcoming rally could resemble the rally which began in September 2001, when the Dow briefly neared 8,000 and rose above 10,000 in three month's time, before once again settling on a long-term downward course.

With the economy undergoing an extended recession, we doubt the forthcoming stock rally will signal an end to the bear market. Stocks which show the most leadership in this rally should be noted for future promise when the bear market ends.

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