



# Rally Approaching

24 September 2008

DJIA: 10,825

In spite of political panic and media frenzy, a rally in stocks may be approaching.

In the course of long downtrends, stocks often move in saw tooth patterns. Thus a rally which began in mid-July took some indices about 9 percent higher over four weeks, before resuming the downtrend. In the ensuing financial storm, Lehman, Merrill Lynch, Fannie Mae, Freddie Mac, and AIG joined Bear Stearns, all major players, in distress. Last week stocks began a rebound from the 14 percent decline, but pulled back as Congress began to debate relief proposals. We saw lots of volatility, mostly on the downside!

There are good reasons to look for a lengthier rally on the horizon; one which could give investors a bit of breathing room:

- Regardless of the plan's merit, US Treasury assistance will absorb many of the bad mortgage loans clogging the system. Congress heads this for early passage. Why? It is an election year.
- A variety of technical indicators are extremely bullish: Internals showed extreme fear among investors last week. Once again, according to *Investors Intelligence*, advisers were more bearish than bullish by a 6 percent margin. The VIX fear index reached a high of 45.8 last Thursday, a five year high. Also at a five year high was the 2.17 ratio of put to call premiums. Closed-end fund discounts hover nearly 9 percent below market value.
- Our James leading intermediate indicators are bullish by a ratio of more than 3:1.

Stocks were recently 28 percent below their 2007 peak. It is likely we are nearing a temporary bottom, one which could last for a time. We believe that this is not the end of the bear market; an extended recession lays ahead, one caused by lender greed and borrower irresponsibility. Banking reserves are depleted enough to make credit scarce, but the system will survive as Americans overcome almost all obstacles. Our relatively cheap exchange rate and technological competence will push along exports. Industrial, technology, and consumer staples should be favored.

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