

July 21, 2009

The Stock Market is Anticipating Good News

But how can it go up when unemployment is rising?

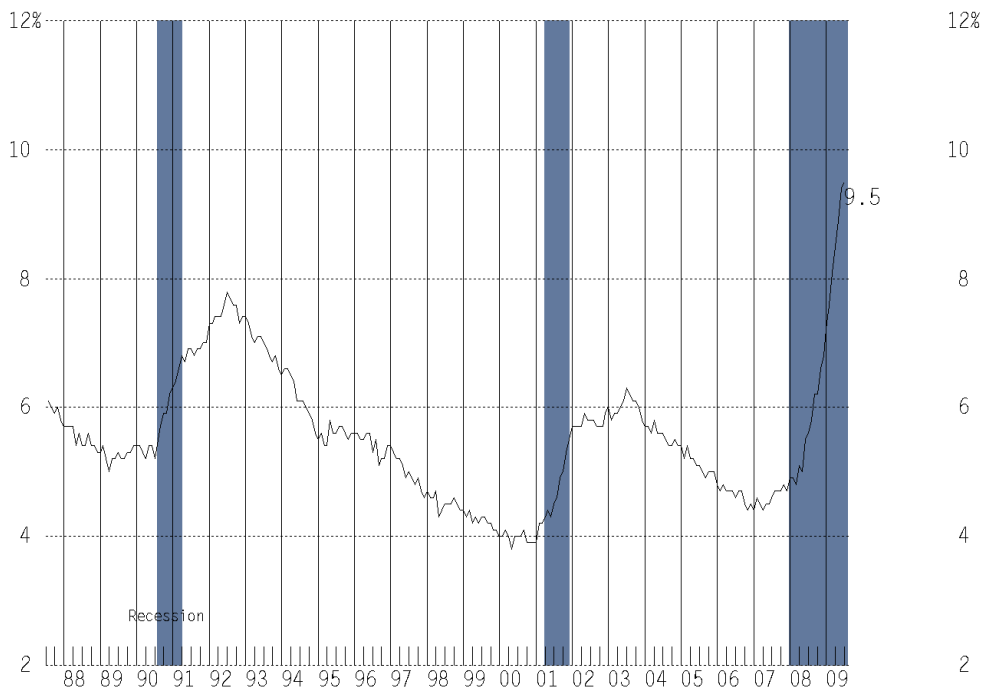
At this stage in a recovery investors are always faced with the problem of a rising stock market coupled with bad economic news. The combination results in lots of suspicion about stocks and doubt about a continued move higher---this year is no exception.

Number one on the list of bad news items is the unemployment rate. But as the chart below illustrates, using the unemployment rate to predict the end of a recession just doesn't work. Unemployment continues to rise after the recession ends. Further, using the unemployment rate as a guide to stock investing is like driving while looking in the rear-view mirror.

UNEMPLOYMENT RATE

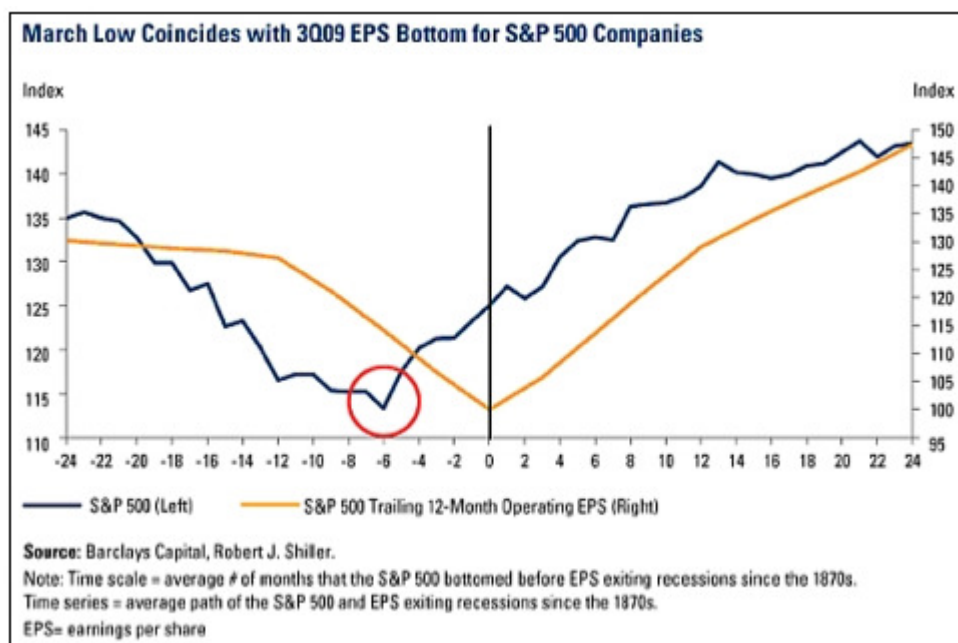
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Percent



On top of the rising unemployment rate, corporate profits are still way down from the peak. How can the market ignore that?

The chart below shows the average 48 month record of bear markets in stocks and earnings per share drops and recoveries. On average the market hits bottom six months before the turn in earnings. If the low in March was indeed the market bottom then earnings should begin to improve for the S&P this fall. Since earnings are coming in stronger than expected in the current quarter there's reason to be cautiously optimistic about next quarter.



Waiting to invest in stocks until the news is good on the economy and profits results in mediocre returns without reducing risk very much.

July is turning into another good month for the market and our portfolios despite many predictions (including our own) of a very dull summer for the market. The market may still disappoint us in the short run, but looking out a year we are confident that investors in high quality stocks will be well rewarded.

Best regards,

Daniel A. Ogden

PS Any questions regarding this note can be directed to me at dogden@dockstreet.net.