

Eye of the Storm or End of the Storm?

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As avid weather enthusiasts, we at FFA can't help comparing the continuing (never-ending?!) Great Recession to a F5 tornado. The wall of the storm hits, all heck breaks loose. In the wall all clarity is lost, confusion reigns.

Then, miraculously, the winds stop and the sun appears. The storm has passed. Or has it? On the horizon, we see dark clouds. Are these clouds coming our way or will they pass? Are we in the eye of the storm with more losses to come or has the danger passed?

Unfortunately, we won't be able to know...well...until we know. Until then, we are left to speculate. Regarding the stock market, there are two prevailing schools of thought. The first camp believes the storm has passed and the stock market is leading the way. The other camp believes we are in the eye of the storm and the second shoe is about to drop. (While we at FFA subscribe to this school of thought, the majority of our portfolios are hedged for both scenarios.) Let's take a moment to ponder the two scenarios.

The Bull's Case

For the "bulls" (the storm has passed) out there, recent history certainly lends great support to their case. Over the last 34 trading days, the Dow Jones Industrial Average has jumped over 1,600 points or 25% and the Russell 2000 (small U.S. stocks) has gained over 43%. Certainly our stock holdings have been positive for two months in a row, most very pleasantly so.

The bulls are seeing "green shoots" of sprouting economic growth. Actually, the mantra is not necessarily one of growth; it is the concept that being "less bad" is actually good. Thus, when Chrysler goes bankrupt and a pandemic flu is brewing, stocks rise. Bad news in the current environment is discounted, good news, fleeting as it may be, is carrying the day.

The Bear's Case

The "bears" (we are in the eye of the storm) see this current stock rally as a "dead-cat bounce"; Wall Street lingo for a rally within a bear market only to be followed by another calamitous drop. Current proponents of this case see the Dow dropping below its previous low of 6,547 which would be a 20% drop from today's level.

The bears believe the green shoots are actually weeds, not flowers. Each negative economic release drives their point home deeper. Certainly the employment and housing numbers are helping support their case. While the bears can't argue the recent rally in stocks, they quickly point to the fact that the Dow is still down almost 6,000 points or -42% since October of 2007.

Reality Wins

The reality is neither bears nor bulls know what lies ahead. The vast majority of the greatest business, financial, and economic minds did not see the Great Recession coming. We at FFA certainly did not.

Reality tells us that economic times remain ugly, that "less bad" is not a solid foundation to build on, that no matter the short-term positives, the bill will ultimately have to be paid for the unprecedented deficit spending that continues to grow daily, and that the world is in the largest global recession since the Great Depression.

About Recency Effect

Psychologists have known for years about the power of the "Recency Effect". Simply put, this means we as humans have a strong tendency to overemphasize the most recent experience, event, data point, etc. Thus, with two months of strong stock gains, we all breathe a collective sigh of relief that the storm is possibly over. Recent events dominate our responses and the collective positive spin by the media, Wall Street, and the Obama administration are helping boost the nation's psyche.

Yet, if we reflect back to early March when our stock investments were at their lows, certainly the storm was not over. Feelings of helplessness abounded and market strategists warned of calamity around every corner. As of this writing, there is hope in the air and the calamity has not arrived. We at FFA, unfortunately, still see storm clouds in clear view; only time will tell their ultimate path.

As always, we thank you for your continued trust and confidence in these still historic times.

Best Regards,

Berthann & Craig

P.S. We had intended to send our first survey to our clients last week. Alas, we did not meet our goal. We expect to have it sent prior to the end of May and ask the favor of five minutes of your time to tell us how we can improve. Thank you in advance.