A Drunk on a Bicycle

April 16, 2010

I've been generally correct about how economic problems have developed in the current crisis. And thankfully, most of my advisory clients were positioned defensively so their portfolios saw only a fraction of the financial carnage that most investors experienced in 2008.

But clearly I've been wrong about how high the stock market would rally in the midst of this mess and how disconnected it would get from the economic icebergs still lurking beneath the surface.

There…how's that for an unvarnished truthful admission rarely heard in the financial industry?

Our economy is kind of like a drunk on a wobbly old bicycle…like in one of those old Charlie Chaplin type movies. Mr. Drunk is trying to ride his bike across a narrow walking bridge that has no handrails. Not only does he have to steer straight but, importantly, any loss of momentum and he's headed for a bath in the creek below. However, from the way stock markets are behaving you'd think the rider is Lance Armstrong and that he's already successfully navigated two or three such bridges.

While it appears that momentum *may* keep pushing the markets higher for a while, the fragile underlying economic data still tells me the glass is half empty. The economy is not just about income, spending, and fund flows, though that seems to be the overarching concern of most economists, global governments, and the investment industry. The economy is also about debt loads, balance sheets, and sustainability without artificial government interference.

I strongly disagree with the economics of John Maynard Keynes (1883-1946), but he had some of the greatest pithy quotes. It's times like this that remind me of his words to the wise:

> "The market can stay irrational for longer than you can stay solvent."

Due to my concerns about the *real* economic picture, I reduced equity positions in advisory client portfolios along the market's recent rally. And though clients may hold a few preferred stocks, non-traded REITs, and some precious metals, we've basically been out of stocks since the S&P500 landed around 1025. That's typically a good capital preservation move in an overpriced stock market. But with the S&P500 now around 1200, that means we missed the most recent 17% or so of this rally.

I want to thank clients for their patience and confidence during these trying times. It's hard to hold the line at prudence while others in the crowd are in "party on" mode, isn't it? But it'd probably be one of the worst moves to jump back into stocks at these elevated levels, except perhaps for the most nimble of short-term traders. Jumping in now would be like arriving at 11:45 PM to a party which is probably going to end around midnight. We win the investment game not by following "the herd," but by seeking prudent gains while avoiding catastrophic losses.

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Glass Half Full

Notwithstanding the assertions of the perm-bear crowd, there actually *have* been some economic improvements lately. Most of these developments have two sides, but let's be intellectually honest and acknowledge what appears to be getting better (or at least "less worse"). Consider:

- Jobs

Job losses appear to have slowed, with a possible trend reversal in process. The Bureau of Labor Statistics (BLS) reported an increase in March 2010 non-farm payroll (NFP) numbers at 162,000. And the January and February data were also revised upward.

46,000 of the March jobs were US census workers—and those jobs will be gone once the census is finished. But that still leaves us with 116,000 jobs. The US economy needs about 100,000 to 120,000 net new jobs created each month just to keep up with population changes, etc.

Though the BLS's Birth/Death adjustment in the job numbers has been notoriously out to lunch throughout the crisis, if they're anywhere close with this initial March number then this is moving in the right direction.

Of course, there's a flip side…average hourly earnings dropped, headline unemployment is unchanged at 9.7%, the broadest measure of underemployment was just shy of 17%, and the long-term unemployed continue to become a larger pool.

The BLS will likely report large positive job numbers over the next couple of months. Be sure to look through those headline numbers and deduct the census workers (many still to be hired) to arrive at something closer to the real picture.

- Manufacturing

Iacono Research reports that manufacturing is not only rebounding but appears to be accelerating: "The Empire State index jumped from 21.9 in March to 31.9 in April, just short of its high of 33.4 last October, and the inventory component rose to a record high."

Floyd Norris reported in the New York Times (April 9, 2009) that orders are accelerating around the globe. And it's not only manufacturing but also service providers.

Some of this may be attributable to residual stimulus (here and overseas), but it appears that it's also sustainable organic growth.

- Corporate Earnings

Corporate earnings have been improving, which is contributing to enthusiasm for the stock market's prospects. Some is stimulus residual, some is sustainable demand. Some of it involved cost-cutting by firing workers. But once fired, what do you do for an encore? You can't fire them twice.

Most of the gains in corporate earnings are a "legalized lie" in financial sector. According to calculations by David Rosenberg of Gluskin Sheff, financial sector profits account for roughly 85% of the overall increase in corporate earnings. I'll go into some detail on the "lie" aspect later in this update.

- Retail & Wholesale

Retail sales have been up in recent months. I reluctantly place it in the "glass half full" category, but it's perceived as a positive and represents consumers coming out of their bunkers. Having said

that, the problem with a lot of recent positive headline reporting is the complete omission of any analysis as to what's driving the improvement and whether it's even sustainable.

The US Commerce Department reported that US retail sales rose 1.6% in March, which was the biggest advance in four months. Prior month data was also revised upward. March was the 7th consecutive month of retail sales growth. And sales at the wholesale level increased for the 11th consecutive month in February.

Some of this is almost certainly general sustainable demand. Some is due to huge recent incentives (autos, and "cash for appliances" programs). A substantial portion appears to be seasonal, related to income tax refunds, and that will probably end shortly.

Iacono Research (April 17, 2009 report) notes that "sharply higher tax refunds – some $350 billion according to recent reports – have no doubt boosted sales and, while nearly every measure of consumer confidence still indicates Americans are cautious, what they say and what they do are often times two very different things."

Though difficult to quantify, a large part of the retail sales improvement appears to be redirected mortgage money. In other words, people who stopped paying their mortgage long ago but who haven't been foreclosed and kicked-out of the home. This large pool of freed-up funds is finding its way into retail spending, and I'll go into this in some detail later in this update.

To provide a bit more context, David Rosenberg of Gluskin Sheff notes that government transfer payments now represent about 20% of the overall "personal income pie." Did you get that? $1 out of every $5 in personal income is doled out by the government. So that's obviously helping retail sales in the short-term.

Glass Half Empty

We are way too complacent about the significant economic risks that are *still lurking*. And it's times like that when the proverbial "black swan" shows up and catches you off guard. Here's a non-exhaustive list of real economic problems that *should* be tempering the enthusiasm in the stock markets.

- Financial sector

On April 2, 2009, under pressure from politicians and regulators, the Federal Accounting Standards Board (FASB) suspended Rule No. 157. This rule previously required that assets be recorded in the financial statements at their true market value…in other words the price that a willing buyer would offer a willing seller. It was known as the "mark to market" rule.

A lot of debt (mortgages, credit card loans, auto loans, etc) that was pooled and turned into investments during the last several years is worth a fraction of its original price. Under FASB 157, the bank or other owner of these so-called "toxic assets" would have to mark the price down to true value and write-off the difference as a loss against their earnings. With the suspension of FASB 157, banks can use discretion as to what value they place on these assets and avoid (or take limited) write-downs. It's essentially an "extend and pretend" stance. They can then pay their management and employees ungodly bonuses based on profitability that doesn't truly exist.

It took lawsuits under the Freedom of Information Act and a great deal of wrangling, but we finally got a small glimpse into the approximate value of these kinds of assets. Banks hold these on their balance sheets and continue to report at or near full value. John Hussman of Hussman Funds reported (April 5, 2010) that the US Federal Reserve was forced to reveal assets it bought during the Bear Stearns and AIG bailouts (so-called "Maiden Lane" portfolios). ***The portfolios are currently worth between 39 to 44 cents on the dollar.*** Hussman notes that these are assets that

Federal Reserve Chair Ben Bernanke and US Treasury Secretary Tim Geitner assured Congress were high quality and would likely turn a profit.

It's important that you understand that the reason these assets aren't worth much is because they're comprised of junk quality debt, not because of some *temporary* depression in prices caused by the recent recession and market panic. Perhaps John Stuart Mill said it best years ago:

> "As a rule, panics do not destroy capital; they merely reveal the extent to which it has been previously destroyed by its betrayal into hopelessly unproductive works....The failure of great banks...and mercantile firms...are the symptoms incident to the disease, not the disease itself."

Suspension of FASB 157 has moved us from "mark to market" to "mark to fantasy." The financial sector is being allowed to pretend that their financial picture is something it is not.

Why? Because the US (as well as global) banking system is technically insolvent. And it's believed that pretending things aren't as bad as they are—coupled with artificially holding short-term interest rates (the cost of money) near zero—will give the banks time to earn their way out of this crisis and be able to absorb the debt write-offs over time.

A similar strategy was implemented back in1982 when Latin America had its debt crisis. US banks holding the debt were technically insolvent. Then Federal Reserve Chairman Paul Volcker implemented a similar strategy of suspending mark-downs…and it worked. But unlike today, "Tall Paul," as Volcker was known then, cracked the whip on the banks and made them get their financial houses in order (by 1984 the crisis was largely over for US banks.) Not so today.

So this whole thing is what I refer to as a "legalized lie." Consider:

- It's morally wrong, punishes the prudent, and rewards those who were reckless.
- It pretends something exists which doesn't. If the government is hell-bent on using this approach, then at least be upfront about it. Don't go through the public relations farce of alleged "stress tests" (early 2009) on our banking system to supposedly demonstrate the system's ability to handle deteriorating economic conditions. Just tell us the truth—we may not like it, but we should be able to handle it.
- Artificially low short-term interest rates create a completely unlevel playing field by giving big financial players the opportunity to borrow at next to nothing and reap huge profits from investment trading activities, not from standard banking activities.
- With artificially low short-term interest rates, returns on secure investments have dropped to a pittance. This harms savers (think: older folks with CDs and savings accounts).
- Since investors don't want to earn near-zero returns on "safe" investments, they are pushed further out on the risk curve into higher-yielding, riskier assets (which feeds the current rally in junk bonds, stocks, etc).
- Since banks don't have to mark down junk assets to true value—and since they're able to make huge profits on money they borrow at basically no cost—financial sector profits have recently soared 240%.
- And because of all this nonsense, financial sector "profits" have accounted for 85% of the overall increase in corporate earnings—which means that pretend profits of the financial sector are the dominant force driving the current (pretend) stock market rally.

And just like a cheesy 1:30 AM commercial on the shopping channel…"But wait, there's more!!"….

Kate Kelly writes in the Wall Street Journal (April 9, 2010):

> "Major banks have masked their risk levels in the past five quarters by temporarily lowering their debt just before reporting it to the public, according to data from the Federal Reserve Bank of New York.
>
> "A group of 18 banks—which includes Goldman Sachs Group Inc, Morgan Stanley, JP Morgan Chase & Co, Bank of America Corp. and Citigroup Inc—understated the debt levels used to fund securities trades by lowering them an average of 42% at the end of each of the past five quarterly periods, then boosted the debt levels in the middle of successive quarters."

This behavior is *after* their near-death experience around the failures of Bear Stearns and Lehman Brothers in the fall of 2008, demonstrating a culture of arrogance that has no intention of voluntarily getting its financial house in order.

Are you outraged yet?

About 140 banks failed in 2009. Through April 16, 2010, we've already had 50 bank failures in the US. While the FDIC has its own non-public list of problem banks, the Unofficial Problem Bank List hit 698 institutions as of April 16. We can probably expect more bank failures this year than last.

- Stock Market

There are a number of methods for estimating fair value of an individual company or a stock market index. Some measure price to sales or to book value. Others measure price to earnings, with some variation on using "operating earnings (sometimes jokingly referred to as "earnings before bad stuff (EBBS)") or earnings after all write-offs and restructuring charges ("reported earnings"). Some use corporate earnings of the *last* 12 months; some use estimates of corporate earnings for the *next* 12 months.

Bullish analysts will use forward-looking 2010 consensus *operating* earnings (without the "bad stuff") and tell you that the S&P500 is currently at fair value. However, by most measures I consider ungamed and more realistic, stock markets are overpriced anywhere from around 18% to 40% depending on method. And if it weren't for the legalized fictitious earnings in the financial sector, it'd be a lot worse.

I find particularly useful Dr. Robert Shiller's cyclically-adjusted PE ratio, also known as CAPE. A PE ratio means the price ("P") is divided by earnings per share ("E"). Basically, Dr. Shiller's method averages the earnings by rolling 10-year periods. That reduces misleading situations, such as the low PEs you get at peak profit margins (i.e. 2007) and the high PEs at trough profit margins (i.e. March 2009).

Using Dr. Shiller's CAPE method, the S&P500 currently has a PE ratio of about 22. The long-term stock market average over the last 130 years is a PE of about 16. That would imply the market is currently about 37% higher than its long-term average.

Equally smart people may differ on which is the best measure for valuing stock markets. But there's one thing about which there's no intelligent debate…high 10-year forward returns in stock markets ***only*** occur when purchase is made at low PE ratios. If you buy stock markets at current levels and hold for 10 years or so, don't expect to get those nice historical returns of 9%-11%.

Even after a monster rally of around 75% from the March 2009 lows, the S&P500 is still down about 24% from its October 2007 highs. (Chart to the right updated from last client letter)

S&P500 (excluding dividends)

Date	Closing Level	Return vs. High
Oct 9, 2007	1565	"The High"
Dec 31, 2007	1468	-6.2%
Dec 31, 2008	903	-42.3%
Mar 9, 2009	677	-56.7%
Dec 31, 2009	1115	-28.8%
Jan 12, 2010	1136	-27.4%
Apr 16, 2010	1192	-23.8%

Stock market trading volume has been very low (we call it "thin" in the industry). And it appears to be driven mostly by large bank computerized trading programs. The question is who are they trading with? Each other? Most fund inflows over the last year or so have made their way into bond funds not stock funds.

The Wall Street Journal (*This Market Has Its Freq On*, April 15, 2010) reports that just six stocks represented over 27% of recent overall stock market trading volume: AIG, Ambac Financial, Bank of America, Popular Inc, Fannie Mae, and Citigroup.

According to Trimtabs Investment Research, corporate insiders have dumped about $15 billion in stock so far this year, but have only bought about $2.5 billion. Do they know something we don't?

- Unemployment

Unemployment insurance claims are still high and recently "spiked" to 484,000 vs. consensus projections of 440,000. The pool of those who've exhausted their initial claims and are now on extended unemployment continues to grow.

But Michael Shedlock (Global Economic Trend Analysis) made an interesting observation….during the Great Depression in the 1930s, economic suffering was apparent everywhere. You saw the soup lines; it was all very visible. By way of contrast, in the current crisis 14 million unemployed are mostly "invisible" because unemployment insurance hides them and because many are living in their homes for free, courtesy of banks that have not foreclosed long after people stopped paying their mortgage.

Food stamp usage is now at a record 39 million Americans, the 14th consecutive monthly increase.

- Foreclosures & Bankruptcies

RealtyTrac reports that foreclosure filings jumped 19% in March (from February) to a bit over 367,000. That's a record high. They also report that the number of homes the banks have taken over soared 35% from last year's levels.

Florida now has a mortgage delinquency rate in excess of 19%.

In the current environment, people who stop paying their mortgages can stay in their home free for many months. Why? Several factors:

- Lenders want to make money on real estate lending but are not in the property management business.

- Lenders don't want to be liable for property taxes, unpaid utilities, and/or home repairs that come with taking over the home.

- Backlog of foreclosures in the system.

- Government programs (i.e. HAMP) instituting a foreclosure moratorium until borrowers have an opportunity to qualify for mortgage modification.

- If a lender takes back a property and legally incurs a loss, they must write-off that loss against income. Not taking back the property allows lenders to continue reporting at full value and pretending that no loss has been (or will be) incurred.

So how bad is it? Recent reports indicate the national average for such situations is about 13.6 months of free "rent." I recently read one case involving a Ron Nash who stopped making his mortgage payments and stayed in his home for 18 months.

While most of these situations involve people who either (1) have fallen on hard times or (2) should never have been given a mortgage in the first place, there's been a new development in this arena called "strategic defaults."

A "strategic default" is one where the debtor has the ability to pay but refuses to do so. For example, let's assume a two-income couple who can easily manage the payment on their $400,000 mortgage. Let's further assume that the home they originally bought for $500,000 is now worth $350,000. So they now owe more than the house is worth, with the likelihood it will be *years* before the value gets back to purchase price.

Though this couple can afford their mortgage, for "strategic" reasons they may simply decide not to pay. They know an eventual foreclosure will harm their credit rating. But they believe it's a better outcome than being a debt-slave to a property with underwater values. They then continue living in the home free for months. And that frees up a heck of a lot of money for other spending and free-wheeling (which has shown up in recent retail sales numbers). This is a *growing* societal phenomenon and is happening all over the country.

And how is our government's mortgage modification program going? It's been a dismal failure. Many people are not eligible. Of those who are and get "helped," most end up re-defaulting a short time later. The harsh reality is those folks should never have been given a mortgage in the first place. Reducing their mortgage payment doesn't help them; it simply prolongs the strangulation.

Generally, lenders want to see borrowers whose total debt servicing (mortgage principal, interest, taxes, insurance; credit card payments; other loans) will not exceed 36% of their income. Some lenders will go a bit higher.

Tim Iacono of Iacono Research does a great job of shedding light on the problem in his April 15, 2010 report *The Government's Loan Mod Bizarro World*. Borrowers who've applied for help under the government's Home Affordable Modification Program (known as HAMP) have entered the program with total debt-to-income ratios of 76%-77%. Under HAMP, they *are* getting major reduction in their monthly mortgage payment, but total debt-to-income ratio *after* the modification is still 60%-61%.

My interpretation is HAMP applicants are getting rammed through the system so the administration can report "success" in helping people, even though those in charge *must* know that those "helped" are destined to redefault in short order.

(Understand I'm not intending to be partisan here. It is what it is. I'm an equal opportunity critic of both Demicans and Republicrats.)

There were over 158,000 personal bankruptcy filings in the US in March. That's 35% higher than February and 19% higher than last year.

- Housing

As reported in my last client update (*Wile E. Coyote Still Hasn't Looked Down*, January 13, 2010), there's a huge "shadow" inventory that hasn't been foreclosed and put back on the market. Further, we've just entered the period where Alt-A and Prime loans are being "reset," so expect many more defaults. These homes will glut the market and likely have a further dampening effect on both selling prices and length of time on market.

While it appears that lower-end house prices may be stabilizing in some parts of the country, mid and upper-level house prices are still falling.

With the homebuyers tax credit expiring shortly and the Federal Reserve's completion of its $1.25 trillion mortgage-backed security purchase program on March 31, these will no longer artificially stimulate the housing market.

The Mortgage Bankers Association (MBA) recently reported that 30-year fixed mortgage rates have been rising. This is most likely due to the Federal Reserve's completion of its purchase program noted above.

There have been periodic headline reports of increases in the sales of *existing* homes. And that headline often generates enthusiasm in the financial markets. Note, however, that existing home sales are fairly meaningless in this context. They only generate realtor commissions and some transaction fees. Their primary benefit is making it possible for a mobile work force to relocate from one job to another around the country. Only increases in (completed/closed) *new* home sales really represent contribution to the economy.

Finally, residential real estate problems are not limited to the US. Evidence of housing "bubbles" can also be seen in the UK, New Zealand, Australia, and even Canada. Let's monitor what impact that has on their respective economies if/as the bubbles pop.

- State & Local Government

The Nelson Rockefeller Institute of Government reported that states' personal income tax revenue fell 7.1% in January and February from the same period in 2009. 2010-Q1 reporting is not yet complete, but it appears likely that will be the 6th straight quarter to see a decline.

Laura LaRosa of Glenmede Investment & Wealth Management in Philadelphia believes states may have to contend with three to four more years of budget woes. I think it'll likely be more than that, particularly since (1) governments tend not to deal with financial problems until their back is against the wall, (2) taxpayers seem to be largely tapped-out, and (3) a bigger financial challenge than current budget woes involves the unsustainability of public employee pensions and health benefits.

The Financial Times has reported that the US public pension system faces a shortfall of more than $2 trillion, increasing pressure on already-strained state finances and crimping economic growth. If a few municipalities go through the process of bankruptcy protection and restructuring their pension/healthcare obligations, it seems likely that others will be emboldened to also do so.

- Commercial Real Estate

As reported in my last client update, commercial real estate (CRE) in the US is getting squeezed both with loss of lease income and with major refinancing needs. Commercial mortgage debt was estimated last fall to be around $3.5 trillion. US Federal Reserve officials indicate that about $500

billion of that will come due each year over the next few years. Who's going to provide the capital for refinancing?

- National Federation of Independent Business (NFIB)

Small business confidence dropped in March 2010 to eight month lows. Small and medium-sized businesses are the job creation engine of America. And as a group, they've largely been left in the dust with respect to fallout from the current crisis.

If confidence is so low among the job creation engine of America, where do we think the jobs are going to come from?

- Sovereign Credit

Greece has been in the news a lot lately and has major financial challenges.

Satyajit Das, a risk consultant and financial author, notes that Greece is deeply in debt and needs to refinance some €50 billion in 2010, with €25 billion of that by June. Beyond that, they need to refinance borrowings of around 7%-12% of Gross Domestic Product (GDP) each year until 2014. They're currently running a budget deficit of over 12% and borrowing is projected to increase by over 150% of GDP by 2014.

Das said that membership in the European Union "…reduced the ability of Greece to manage its economy. It lost the ability to use its currency, via devaluations, to improve competitiveness and stimulate exports. It also lost the ability to set interest rates (now set by the European Central Bank (ECB)). It also cannot print its own currency to fund sovereign borrowing."

Bottom line is Greece is in a royal mess. They have no good choices, just bad and worse. Negotiations go back and forth between Greece, the European Union, and the IMF. Public announcements get made, the market breathes a sigh of temporary relief, but then looks through the headlines to see little substance behind the pronouncements, and then back to the drawing board. Even now, there are considerable uncertainties.

Default by Greece could cause major harm to fragile European banks which own the debt. In turn, that may cause unintended ripple effects throughout the interconnected global financial system.

Greece is simply one example of a growing list of sovereign credit problems. First it was Dubai, then Greece. Let's not forget that Portugal, Spain, Italy and Ireland are also in line (although Ireland seems to be doing a better job of addressing their budgetary problems than their counterparts).

Demographic constraints are likely to also limit financial options for much of Europe and for Japan.

- China

China's real estate sector (commercial and institutional) appears to be a "house of cards." We likely can't rely on their published data as representative of what's really happening. Economic growth in China is centered around keeping the construction boom going which, understandably, has driven up prices for cement, steel, copper, and other commodities.

Media interviews with Jim Chanos (Kynikos Associates) and Hugh Hendry (Eclectica Asset Management)—including video footage—have been rather revealing. China has constructed entire cities which are largely empty. Barebones condominiums can sell for around $100,000, while the average middle class Chinese couple may earn combined salaries of around $8,000. Something is very wrong with this picture.

There's too much excess capacity and the middle class is not financially strong enough yet to pick up the slack.

Recent Portfolio Positioning

So due to all these issues, I've defensively positioned advisory client portfolios to protect capital and generate some income while we wait for stock market correction. Each client's situation is a bit different, of course, but broad portfolio allocation was roughly:

55-80%	cash and short-term, high quality bonds (municipal and corporate/credit)
10-20%	investment grade intermediate bonds (corporate, municipal), preferred stocks
0%-10%	non-traded REITs
10%-15%	precious metals

Until very recently, about 10% of portfolios (now in cash) was allocated to non-leveraged, inverse ETFs. With the market's continued rise, we kept "taking it on the chin." So I recently liquidated those positions in favor of possibly reinvesting when market momentum appears to be turning around (downward).

Where Do We Go From Here?

In my last client update (*Wile E. Coyote Still Hasn't Looked Down*, January 13, 2010), I provided a chart illustrating my outlook on the likelihood of various events or circumstances unfolding.

This still represents my outlook. But since these things are moving targets, I'd like to offer one variation: if momentum, cheap money, good corporate earnings (including fictitious bank earnings), and election year largesse continue grinding stock markets higher, perhaps we may not see the market correction until some time in 2011.

Event or Circumstance	Likelihood of Occurring per McClanahan
New secular (long-term) Bull market like 1950-1965 and 1982-1999	"In your dreams, buddy" (0 out of 10 chance)
Continue stock market rally through 2010	1 out of 10 chance
Stock market meanders within trading range for several years	3 out of 10 chance
25%-30% correction in stock market prices during 2010	5 out of 10 chance
Stock market drops below March 2009 lows (before eventually recovering)	1 out of 10 chance

The US Federal Reserve keeps stating that short-term interest rates may remain low for an "extended period." If the cost of money remains cheap, that may continue to push investors toward riskier assets (junk bonds, stocks, commodities). And if this is carried on long enough, the spending and growth side of the economy may begin to gain traction, notwithstanding the other real economic problems I've detailed.

In a credit-based economy that lives on liquidity and consumer and business confidence, if participants "drink the kool-aid" this can end up becoming somewhat of a self-fulfilling prophecy. But a resurrection of spending and confidence does nothing to rectify the underlying balance sheet problems that continue hanging around the economy's neck like a dead Albatross. It would just set the stage for the next crisis—likely bigger than the last and arriving sooner than anticipated.

Having said that, if the extreme or prolonged stimulus causes the economy to begin gaining traction, I may need to alter investment strategy along with the moving target. In such a case, it may be appropriate to seek reentry to the stock markets at somewhat higher levels than I might otherwise.

The global economy is very fragile—it's a drunk on a bicycle. And it doesn't take much of a shock or loss of momentum to knock him over—natural disaster, war/terrorist attack, epidemic, major financial default, major financial fraud, etc. The domino effect can be very powerful and you never know what can trigger the tipping point.

This is why it's so important to invest defensively when real underlying economic problems are known, as they are today. When the market turns, buyers of stocks dry up and sellers have nowhere to go. The market can turn down in a hurry. It's kind of like shouting "Fire!" in the theater…you may have a beautiful Rolex watch, but you probably won't get much more than $20 trying to sell it when everybody's heading for the exits.

If you'd like to discuss any of these matters, please feel free to contact me at the number or through the web site below. Until next time….

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