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Market Musings

8/1/2008



Small caps outperformed the big boys in today's market ... but another bank went under!

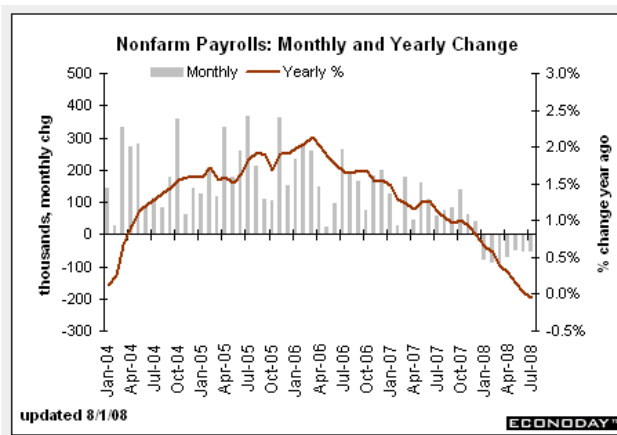
| Markets Diary | | | |
|---------------------|----------------------|----------------------|-------------------|
| Issues | NYSE | Nasdaq | Amex |
| Advancing | 1,582 | 1,413 | 455 |
| Declining | 1,579 | 1,417 | 675 |
| Unchanged | 84 | 139 | 86 |
| Total | 3,245 | 2,969 | 1,216 |
| Issues at | | | |
| New 52 Week High | 28 | 33 | 10 |
| New 52 Week Low | 90 | 74 | 23 |
| Share Volume | | | |
| Total | 1,218,960,303 | 2,146,474,647 | 20,913,685 |
| Advancing | 540,030,823 | 734,762,748 | 9,549,300 |
| Declining | 673,042,280 | 1,345,995,397 | 10,650,355 |
| Unchanged | 5,887,200 | 65,716,502 | 714,030 |

Unemployment up to 5.7%, auto sales continued lower and construction spending was anemic ... but the markets ended hardly changed despite the economic news this week. And next week gives us the FOMC nonsense.

The mixed market took place despite a \$15.5 billion quarterly loss from GM and an increase in the price of crude oil. Israel's prime minister said that Iran is close to a major breakthrough in it nuclear weapon program and many traders priced in a possible war premium.

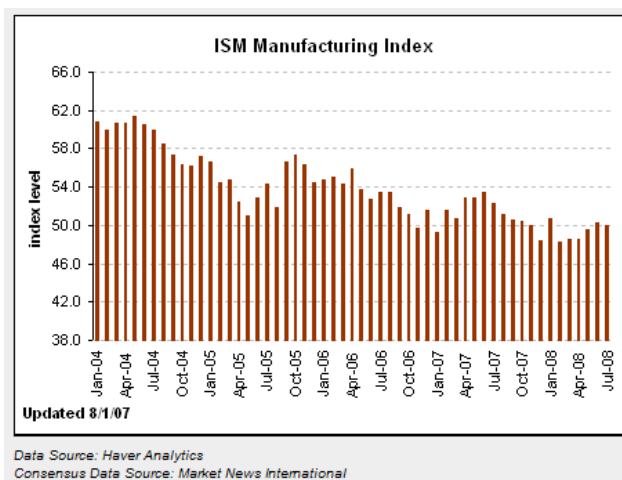
Despite the continual shrinkage in jobs even after the unbelievable birth/death rate adjustments which defy logic, we have economists who argue that we don't have a recession. Of course, the U.S. is in a recession ... take a look around you and forget all the semantics ... it is as plain as the nose on most faces if you look.

The July jobs report showed the seventh consecutive decline in payroll jobs and a 5.7% unemployment rate as a headline item. Even so, the 5.7% rate was the highest in four years. The non-seasonal adjusted rate was 6% and the real rate prior to the Clinton changes is running at 10.8%. On a yearly basis, non-farm payrolls are down slightly. However, one should consider that the birth/death rate adjustment factor has added over 1 million jobs to the count during the last year.



The combined domestic-and-import unit sales rate fell to 12.5 million from June's 13.6 million. The rate is the lowest since November 1991.

The good news, maybe, was in today's ISM Manufacturing report. Production and employment popped higher in the ISM's manufacturing report for July but, in an ominous reading, new orders fell nearly 5 points to 45.0 for the lowest reading since the 2001 recession. Backlog orders also declined, down 4-1/2 points to 43.0 for its lowest reading since early 2003.



We made no changes in the portfolios today. This weekend we are in Kittanning, PA for a family reunion before heading back to Dallas on Monday evening. I do believe that the highways and motels are less crowded this summer than in years past. Moreover, while talking with a highway patrolman at a restaurant in Indiana, he noted that most of his compatriots were not patrolling as much but running radar at stationary locations to save fuel. Guess \$3.85/gallon is a strain on state budgets also.

Enjoy the weekend.

7/31/2008



The odds that this follow-through day will fail just went higher!

| Markets Diary | | | |
|------------------|------------------------|---------------|------------|
| | 5:50 p.m. EDT 07/31/08 | | |
| Issues | NYSE | Nasdaq | Amex |
| Advancing | 1,206 | 1,344 | 549 |
| Declining | 1,960 | 1,543 | 617 |
| Unchanged | 100 | 131 | 103 |
| Total | 3,266 | 3,018 | 1,269 |
| Issues at | | | |
| New 52 Week High | 33 | 38 | 17 |
| New 52 Week Low | 62 | 66 | 27 |
| Share Volume | | | |
| Total | 1,434,063,383 | 2,327,235,010 | 26,399,965 |
| Advancing | 445,540,113 | 971,460,326 | 8,353,920 |
| Declining | 979,651,070 | 1,343,338,260 | 16,406,845 |
| Unchanged | 8,872,200 | 12,436,424 | 1,639,200 |

The market continues to vacillate in reaction to each piece of news. It appears to be caught between the positive bias of investors and the cold fact about the economy. Up one day and down the next. A sense of direction appears to be missing.

Here is the results for July 2008 .. the markets thrashed around but hardly moved for the month.

| Date | DJIA | S&P 500 | NASDAQ | Russell 2000 |
|-----------|----------|---------|---------|--------------|
| 7/1/2008 | 11382.26 | 1284.91 | 2304.97 | 691.59 |
| 7/31/2008 | 11378.02 | 1267.38 | 2325.55 | 714.52 |

GDP for the 2nd Quarter of 2008 was up only 1.9% while the first quarter of 2008 was revised downward. This was below expectations so the early market direction was negative. Do you wonder how bad it might have been if the rebate checks had not been sent out. In addition, revisions were made to the series starting in 2005 and almost all were negative revisions.

And of course, good old Easy Al went on CNBC today to offer up some interesting info:

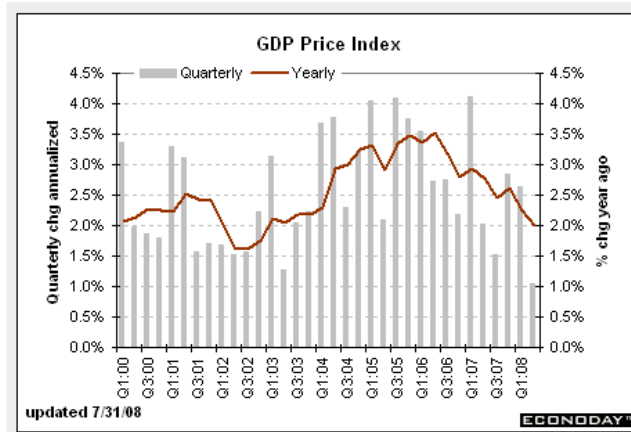
Former Federal Reserve Chairman [Alan Greenspan](#) said falling U.S. home prices are ``nowhere near the bottom'' and the resulting market turmoil isn't showing signs of abating.

While the odds of a recession are 50-50, achieving stable markets will ``take a while," Greenspan said today in a CNBC interview. He also stated that FNM and FRE remained a "major accident waiting to happen" and should be nationalized.

Easy Al was also critical of using the FED's balance sheet to shore up the banks.

You really have to wonder about the chutzpah of the former FED chairman! Every time he speaks, he further reduces his reputation in my opinion. But Easy Al is only human ... keep the spotlight on!

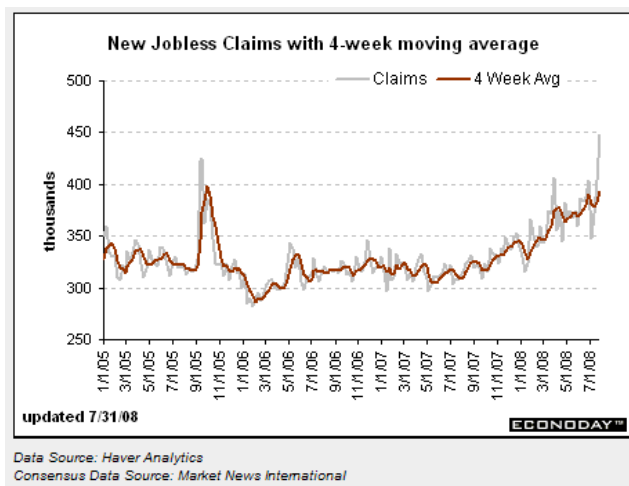
The GDP price index is so out-of-touch with reality. John Williams of Shadow Government Statistics commented that the implicit price deflator (IPD) or, inflation level, was rising at only 1.1% in the 2nd quarter. The IPD was at an incredible annualized 1.1% for the quarter, down from 2.56% in the first quarter, and at the lowest level seen since second-quarter 1998. The lower the IPD inflation, the stronger will be the inflation-adjusted growth. **Can anyone actually believe that number? And if you don't what does that say about the GDP number?**



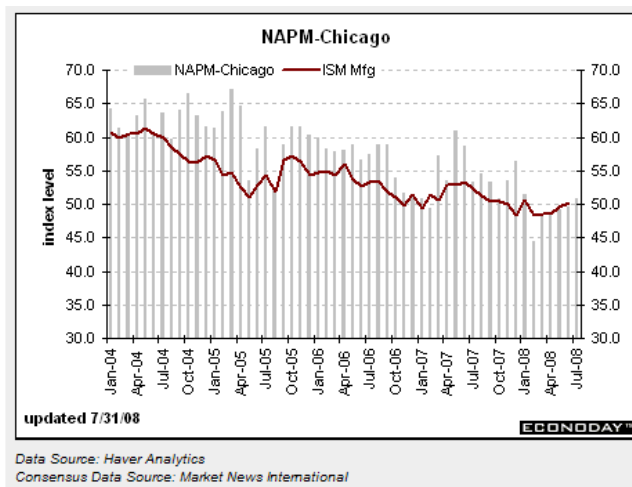
The Employment/Cost index is not keeping pace with rising food/energy prices so the working class is definitely being squeezed.



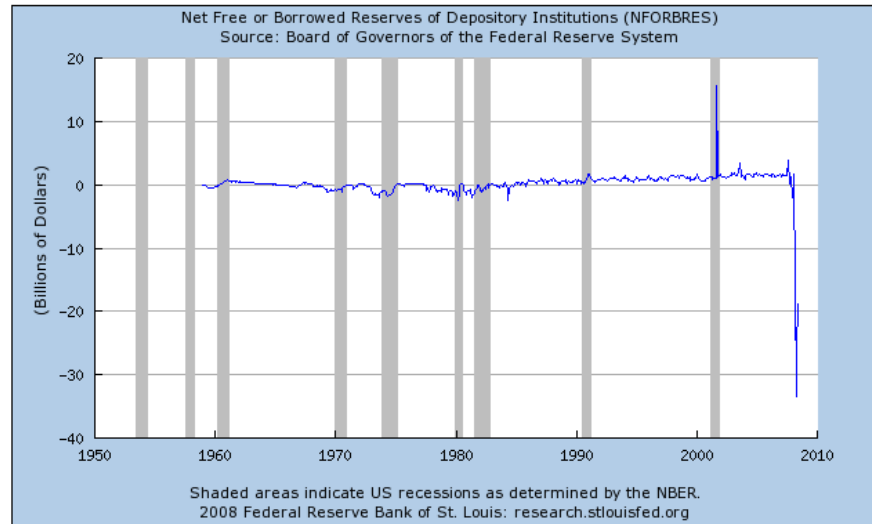
New jobless claims soared to 448,000 in the last reporting week. Continuing claims also showed enormous pressure, up 185,000 to 3.282 million for their sharpest one-week gain in more than 10 years. Watch out for a higher unemployment rate tomorrow.



Today's good news was a move above the 50 level for the NAPM reading. This is the first time in six months that the reading has been in positive territory. New orders have been solid in this series and remain so, at 53.5 vs. 52.0 in June and 56.1 in May. Prices paid is a big headline in the report, at 90.7 for the highest reading since a 90.9 level in March 1980.



The FED's extension of the various special borrowing agreements continues to show the increasing strain on the financial system in the U.S. Net non-borrowed reserves continue to be negative and are increasing as shown in the following chart.



After a day driving through Eastern Iowa, Illinois and half of Indiana in and out of rain showers, we must comment that the crops are looking pretty good although there is a great deal of variability. About 20% of the corn is probably late in development. An early frost or more flooding rains will play havoc with this years production.

Tomorrow it is off to Pennsylvania and more crop inspections on the way.

We made no changes in the portfolios today. We did update the Watch List.

7/30/2008



Two up days ... are we in another rally attempt?

5:52 p.m. EDT 07/30/08

| Markets Diary | NYSE | Nasdaq | Amex |
|---------------------|---------------|---------------|------------|
| Issues | | | |
| Advancing | 2,112 | 1,587 | 757 |
| Declining | 1,065 | 1,241 | 399 |
| Unchanged | 91 | 160 | 117 |
| Total | 3,268 | 2,988 | 1,273 |
| Issues at | | | |
| New 52 Week High | 47 | 46 | 11 |
| New 52 Week Low | 60 | 63 | 32 |
| Share Volume | | | |
| Total | 1,441,138,089 | 2,243,524,349 | 31,837,856 |
| Advancing | 1,020,939,469 | 1,290,479,379 | 23,872,085 |
| Declining | 411,581,720 | 867,838,284 | 6,632,871 |
| Unchanged | 8,616,900 | 85,206,686 | 1,332,900 |

Gee, maybe I should travel more. Up before dawn to drive to Des Moines with the first 100 miles from Liberty, Mo in heavy rain for a Hertz Farm Management Land Owner seminar. Arriving at the registration desk with just minutes to spare, they requested that all cell phones be left outside the meeting room. When the meeting was over, the markets had ended higher for the second day in a row.

Notes from the Seminar:

The consensus for agricultural prices and land prices was that prices would not fall to 2006 levels and land prices would probably move higher. **Of course, in my opinion, the consensus is rarely correct.**

What was most interesting was that almost to a speaker or person in the audience, the USDA crop estimates for corn and soybeans were too high and maybe by as much as 10% or more. If that is the case, look for even higher

prices for commodities like corn and soybeans and land also.

There appeared to be concern about the new ACRE farm program and most were confused about how it might affect their operations. In 1970, over 70% of all crop leases in the Midwest were 50/50 crop share. Today, over 50% is cash rent (\$275-\$325/acre) which is going up significantly as 2009 leases are re-negotiated. Owners with custom farming operations have year in year out outperformed all other types of owner/operator/tenant leases.

After the meeting, I headed to North Central Iowa and observed a tremendous variability in the appearance of crops. Iowa continues to have too much rain and many fields from Des Moines to Fort Dodge had standing water. We saw several fields that had not been planted and many that had been replanted. The results of Pro Farmer's & John Deere's Crop Tour starting next week should answer many questions about the size of this year's corn and soybean crops. The best crop conditions appear to be north of U.S. 20 and west of I-35.

Tomorrow, we will head east of I-35 into East Iowa and Northern Illinois.

ADP reported 9,000 jobs added in July and people were encouraged. Of course, it takes about 235,000 new jobs each month to keep up with population growth. But it was an increase that got people excited. Expectations were for a decline of 60,000.

This index has overstated employment for eight months. Indeed, the Labor Department (released Friday) has reported a decline in private payrolls for seven consecutive months while this report has had only two declines. The ADP report had a component in the financial jobs area that increased 4,000 in July. **Now if you believe that item, you might be interested in buying the San Francisco Bay Bridge cheap?**

Investors appeared to ignore as the following: MBA's purchase and refinance indexes both plunged in the July 25 week, hit by high interest rates and apparently by declining demand in the housing sector.

Unlike yesterday, crude oil rose over \$4.50 today as gasoline stocks were lower in this week's report. **Talk about fickle markets ... jinking the way the latest number tilts.**

The FED announced its intention to extend the special financing arrangements for banks and investment banks (the Primary Dealer Credit Facility (PDCF) and the Term Securities Lending Facility (TSLF)) until January 30, 2009. It also said that it will introduce 84-day Term Auction Facility (TAF) loans. The Fed also announced they will auction up to \$50 billion options on the Term Lending Securities facility (TSLF), lasting two weeks or less. **The actions were taken as fragility continues in the financial market but will be withdrawn when needed. Does anyone really believe that the toxic waste on the FED's balance sheet will ever be repurchased by the original holders of that paper?**

We made no changes in the portfolios today. We also due to time constraints did not update the Watch List.

7/29/2008



Bouncing up on higher volume ... a follow-through day.

| Markets Diary | | | | 5:45 p.m. EDT 07/29/08 |
|---------------------|---------------|---------------|------------|------------------------|
| Issues | NYSE | Nasdaq | Amex | |
| Advancing | 2,474 | 2,048 | 689 | |
| Declining | 714 | 856 | 485 | |
| Unchanged | 71 | 114 | 108 | |
| Total | 3,259 | 3,018 | 1,282 | |
| Issues at | | | | |
| New 52 Week High | 22 | 29 | 10 | |
| New 52 Week Low | 80 | 57 | 44 | |
| Share Volume | | | | |
| Total | 1,389,581,040 | 2,284,125,851 | 30,077,108 | |
| Advancing | 1,143,382,020 | 1,722,323,533 | 18,269,078 | |
| Declining | 234,455,020 | 553,220,488 | 10,782,010 | |
| Unchanged | 11,744,000 | 8,581,830 | 1,026,020 | |

See what happens when I head to a meeting and then drive from Dallas to Kansas City in the afternoon. The market recovered from its Monday loss and had a follow-through day!

While economic data was mixed, the consumer confidence level moved up to 51.9 (still dismal as it was only up from a 16 year low) while the Case-Shiller index of home prices had its largest drop in May (the y/y drop is 15.3%). Another drop in crude prices and Merrill, Lynch's stock offering helped drive the markets higher. Merrill is financing 75% of the sale of those CDO's sold at about 22% of face value ... some deal!

Retail sales are seeing the final effect of the economic stimulus checks so watch August sales numbers closely to see if the uptick is real.

Tomorrow we will be in meetings all day in Iowa so tomorrow's Musings as well as the balance of the week will be short due to our travel schedule. On the way to Kansas City, we noticed that the corn crop in northern Texas and most of Oklahoma was in poor condition. In southern Missouri around Joplin, the stalks were showing signs of firing although as we continued towards Nevada, the corn crops looked decent. Soybeans appeared to be suffering and had not canopied yet. It will be very interesting to get the Pro Farmer crop reports from their August tour.

We remain mostly in cash and are keeping our fingers crossed that a rally will develop. However, it would seem to me that prudent investors should be extremely cautious. We did not update the Watch List tonight due to time constraints.

7/28/2008



So much for that rally attempt!

| Markets Diary | | | |
|---------------------|---------------|---------------|------------|
| | NYSE | Nasdaq | Amex |
| Issues | | | |
| Advancing | 867 | 737 | 463 |
| Declining | 2,312 | 2,137 | 731 |
| Unchanged | 85 | 115 | 97 |
| Total | 3,264 | 2,989 | 1,291 |
| Issues at | | | |
| New 52 Week High | 15 | 28 | 20 |
| New 52 Week Low | 78 | 75 | 30 |
| Share Volume | | | |
| Total | 1,163,814,248 | 1,938,807,295 | 23,936,337 |
| Advancing | 226,423,590 | 271,452,990 | 9,212,395 |
| Declining | 929,116,028 | 1,659,074,077 | 13,963,142 |
| Unchanged | 8,274,630 | 8,280,228 | 760,800 |

Although Congress passed the housing bill along with an \$800 Billion increase in the federal debt limit, today's market action suggests that the financial sector and housing still face a hard road ahead.

Today's close wiped out the gains from last week's rally and the market closed at its lows for the day with declining issues and volume crushing their opposing numbers. The DJIA, S&P500 and NASDAQ closed today at their lowest levels since July 15th. The indices are now near critical support levels which breached could find the markets headed much lower.

Puts on financial stocks, FNM, FRE and the homebuilders might be profitable in the coming months. The IMF which often is late to the party reported today that housing is still overpriced in the U.S.

In the 700 page bill passed by Congress there were several items totally unrelated to the basic thrust of the bill. In fact, probably more than 80% of those voting on the bill had no idea of what the bill contained. The bill as passed provides the following:

- A blank check for FNM and FRE as the bill makes the once implicit government guarantee explicit with no protections for the taxpayers and no cap on a bailout.
- Gives FNM and FRE a larger cap on the mortgages which they can hold. The guarantee is increased to \$625,000 from \$417,000.
- Provides \$4 Billion to states to purchase foreclosed properties that banks have already foreclosed.
- Increases the FHA limit for conforming mortgages to \$625,500.
- Provides a tax refund for 1st time homebuyers for up to 10% of the purchase price.
- FHA loans will not require a down-payment of 3.5% from 3%.
- The oversight of the GSE's will continue ineffective as the bill has no teeth in it.
- Increased the federal statutory debt limit by \$800 Billion.

The CBO feels that the bill will only cost \$25 billion through 2009. Any increase in interest rates in the U.S.

along with the future resets (see July 25th's Musings) beginning in 2010 is sure to make \$25 billion look like a drop in the bucket. The legislation amounts to one of the most far-reaching government expansions in the real estate and financial markets in decades.

The Bush administration today projected a higher budget deficit in FY 2009 increasing its estimate to \$490 Billion from \$407 Billion in February.

After the close, Merrill Lynch announced a \$5.7 Billion pretax write-down in the latest quarter due to losses on the sale of mortgage assets. It also announced plans to raise \$8.5 billion by selling new common stock.

Merrill also said it would sell CDO's with at face value of \$30.6 Billion for \$6.7 Billion, 22 cents on the dollar, to an affiliate of private equity fund Lone Star. **Wonder if Merrill is loaning them the money?**

We made no changes in the portfolios today.

7/25/2008

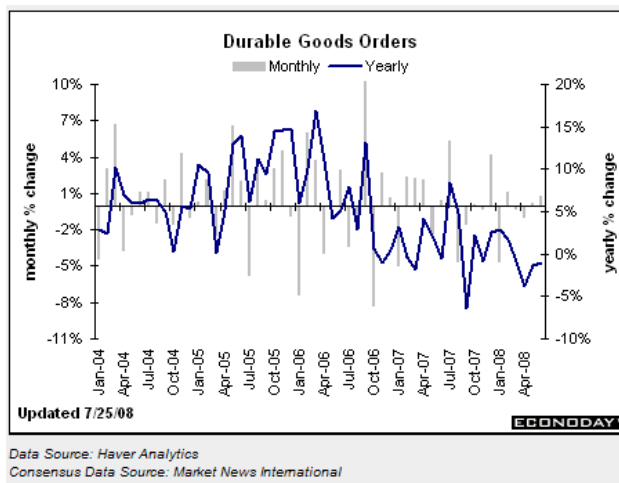


Market went up but volume continues to drop.

| Markets Diary | | 5:12 p.m. EDT 07/25/08 | | |
|---------------------|---------------|------------------------|------------|--|
| Issues | NYSE | Nasdaq | Amex | |
| Advancing | 1,760 | 1,706 | 584 | |
| Declining | 1,339 | 1,078 | 518 | |
| Unchanged | 112 | 131 | 85 | |
| Total | 3,211 | 2,915 | 1,187 | |
| Issues at | | | | |
| New 52 Week High | 44 | 262 | 12 | |
| New 52 Week Low | 109 | 314 | 49 | |
| Share Volume | | | | |
| Total | 1,286,065,476 | 2,049,652,859 | 44,251,156 | |
| Advancing | 668,258,940 | 1,380,620,615 | 20,727,796 | |
| Declining | 591,227,416 | 622,407,699 | 22,573,060 | |
| Unchanged | 26,579,120 | 46,624,545 | 950,300 | |

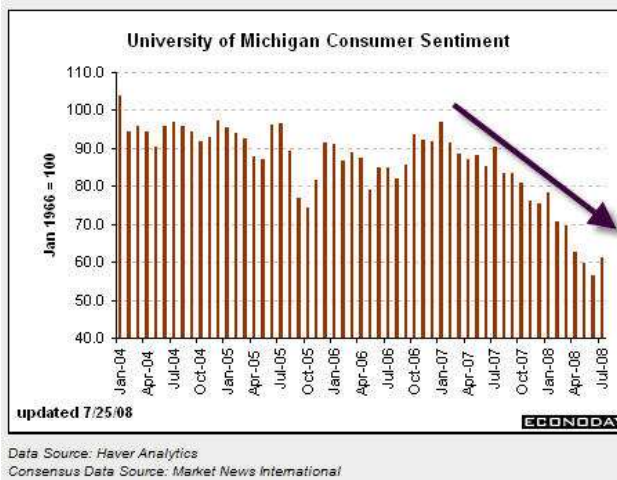
Durable goods orders beat expectations and consumer sentiment was higher than expected which helped the market open higher. Still it was options expiration and advancing issues were dominant.

Durable goods were higher by 0.8% in June but if you eliminate defense orders, they were up only 0.1%. Transportation orders were down 2.6%. Overall, the report was spun as positive although it was not enough to get most analysts excited.

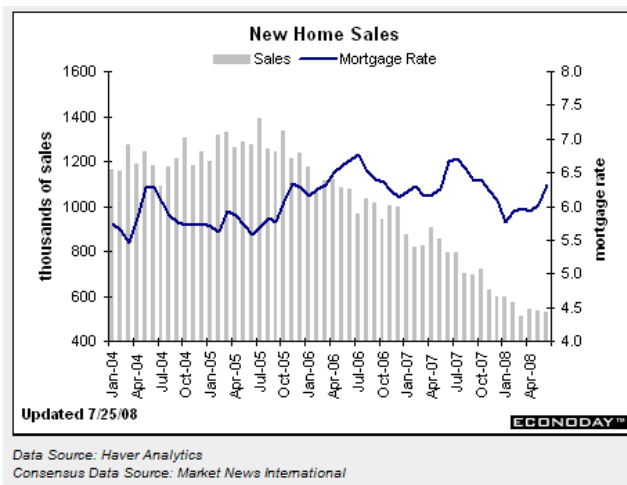


The preliminary read on consumer sentiment showed an uptick to 61.2. However, the trend-line has not

changed and whether the consumer really is more hopeful remains to be seen in future months.

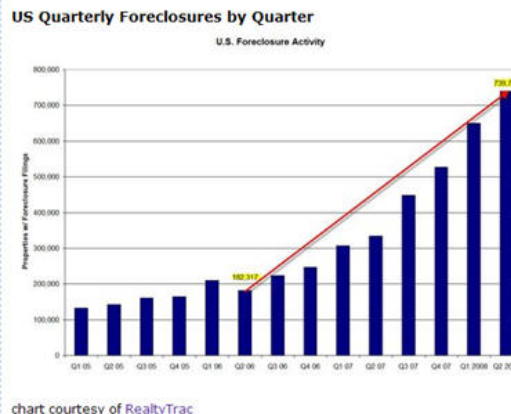


May new home sales continued to move lower and supply continued to grow.



Foreclosure data for the second Quarter was not good showing a 14% increase over the first quarter.

“Forty-eight of 50 states and 95 out of the nation’s 100 largest metro areas experienced year-over-year increases in foreclosure activity in the second quarter.”
-RealtyTrac CEO James J. Saccacio, Q2 U.S. Foreclosure Market Report.



According to RealtyTrac, almost 740,000 properties were in some stage of the foreclosure process, the most since they began tracking this data in January 2005. That represents one in every 171 U.S. homeowners that either 1) lost their house to foreclosure; 2) received a default notice or 3) was warned of a pending auction. This

is an increase of 121% from a year earlier, and is a 14% rise quarter over quarter.

If you think that Congress shoring up FNM and FRE will only cost \$25 Billion, think again. This morning the National Australia Bank's decision to write off 90% of its US conduit loans should shake up investors around the world. If other financial institutions are forced to market to market like NAB, the cost of bailing out these exposures will be beyond the capacity of the world financial system. NAB says that it is suffering a 55% loss on its American housing loans.

Robert Gottlieb writing in the "Business Spectator" of Australia had this:

We are now way beyond sub-prime. NAB says that it is suffering a 55 per cent loss on American housing loans – an event that has never happened in the history of a developed country in recent memory. This is an unprecedented event and means that the cost of bailing out the US financial system is now far beyond the highest estimates.

The global banks have been marking to market the assets they held on their balance sheet, but the vast amounts held in so called 'conduit trust accounts' have not been written down because they were not marketable. NAB wrote them down when they saw the bad mortgages.

US banks have written down \$450 billion in bad housing loans. The revelation from NAB means that they will now certainly need to take provisions to \$1,000 billion. But write-downs of \$1,300 billion and perhaps even more are on the cards.

Where will the equity come from to cover these bad loans? The world has never attempted a rescue effort of this size and it will make liquidity in the globe very tight.

While global banks have been writing down their balance sheet assets, few have tackled their conduit exposures which are off balance sheet but to which they are ultimately liable.

Oil continued lower showing a 4.3% decline for the week. Despite today's increase, the markets for the week were lower.

Tomorrow, the Senate is to vote on the bailout bill that gives a free rein to the FED to destroy the U.S. financial system without any checks or balances. **[For the record, we have developed a pdf file of some charts that will provide a glimpse of how things were before the Senate vote.](#)** You will need Adobe to open it.

We made no changes in the portfolios today.

Have a great weekend.

Fred Richards/Strategic Investing.

Keep it Safe, Simple and Stay Focused!

Last updated - February 6, 2007