TONGE INVESTMENTS

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The Lion & the Lamb
The old aphorism that March comes in like a lion and goes out like a lamb applies more obviously to the stock market than the weather last month. It began with a continuation of the declines from the end of February. My indicator dropped below 67% and all the way to 62% in the first ten days. As measured by the Dow Industrial Average, the market had downward swings of as much as 500 points in a day and went down a total of just over 700 points before recovering to end the month not far from where it started. Some analysts are thinking that our markets are very cheap, citing corporate earnings and the quarter's merger activity as evidence. I say, Beware: we may be looking at a wolf in sheep's clothing.

Much of the month's activity was in response to the sub-prime mortgage market, to actions (or the lack thereof) by the Federal Reserve, and even to statements by the Fed's previous chair. The sub-prime market leaped into prominence as a number of corporations involved in that business suddenly became seriously unstable, even to the verge of bankruptcy. The delinquency rates on this type of loan are now at a level last seen 15 years ago. This development was not totally unexpected nor unpredictable, since the companies were, after all, loaning 125% of a home's value to people whose finances were stretched the most and whose jobs were least secure. You can call it corporate greed or just doing business—the result is the same, a train wreck. The sub-prime problem has exacerbated an already difficult housing situation, with the cumulative effect of reducing total economic growth in the fourth quarter by as much as 1.2%.

Let's turn to the Federal Reserve. All Fed Chairmen are concerned with economic growth; it's what they live for. Even before his appointment, current Fed Chairman Bernanke was known to be focused on inflation as the chief threat to growth. He maintains a target for inflation of 1 - 2%. We are now running at 2.3%, a rate, in his view, "above levels not conducive to achievement of sustainable growth and stability." With this threat in mind, he may be eyeing a rate increase in order to drag inflation back to his target range. By contrast, Wall Street is hoping he will begin decreasing rates in the middle of this year. Chairman Bernanke is in charge. He is responsible for pondering and shaping the large strategy, and the game will be played his way as long as he remains in his post.

Two thoughts in conclusion: The merger activity and overall valuations on Wall Street are encouraging as is the continuing strength of the economy. However, the 700-point drop in the Dow Industrial Average amounted to about 5%. It takes a decline closer to 10% to be counted as a correction, and it's been a long time (4 years) since we've seen such a number. I still expect to see a correction before year's end. Am I just "crying wolf?" We shall see.

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