

April 2010

## Bulls and Bears

“It's hard to see how improving sentiment can override leveraged US balance sheets, anemic demand, high unemployment, and unruly state and household budgets.”

If it's not transparent, 'leveraged balance sheets' means 'You've borrowed up to the hurting place.'

That passage from one of my favorite morning research reports, Hedgeye, illustrates, among other things, the on-going battle between bulls and bears on Wall Street. As the first quarter of 2010 closes, the markets have enjoyed an impressive rally, and consumer confidence ('improving sentiment') is rising. Here's a Main Street experience to make the point: Visit a local restaurant, particularly an up-scale example. A couple of months ago, these restaurants were so unpopulated one might hear echoes bouncing about. Now, they're busy. Some people, at least, are feeling better, like they have a little money left over and are willing to spend it.

Let's call this the bull mentality. The other side, the bear side, has its own knowledgeable participants. Some observers will say that the market has been "climbing a wall of worry" - one of the most dramatic market situations. Others will say that this is a bull rally in a cyclical downturn or, in easier terms, a rally in spite of a deteriorating situation. Whichever, no one knows what this market is going to do tomorrow, a week from now, six months down the road. What some say is that the risk today is much higher than the risk was a year ago when this rally started. Reason? The groundwork for a sustained rally is simply not there.

Focus on two factors: jobs and interest rates. The job market is terrible and the outlook is not good. (Treasury Secretary Geithner: The national jobless rate -- now at 9.7 percent -- is "still terribly high and is going to stay unacceptably high for a very long time." – NYTimes, 1 April 2010). Corporate earnings are deceptively good right now: nearly everyone cut expenses, including specifically jobs. Corporations would be happy to hire workers back, but they are only going to do it when they must, that is, when demand for their products forces them to. Most corporations feel as though they have survived this recession, but they're proceeding cautiously.

Concerning Interest rates: the Federal Reserve raises interest rates in order to avert inflation as the economy heats up. Rates are a kind of governor, increasing borrowing costs for corporations and thereby tempering expansion. But wait, there's more! We have federal deficits "as far as the eye can see..." and when interest rates increase, so does the deficit. Upgrading an old witticism, a trillion here and a trillion there and pretty soon you're talking real money. The only way to pay back and pay down the deficits is by increasing revenue. We may hope government receipts go up because the economy's growing, everybody's working and earning a lot more money. The more likely scenario: taxes will go up.

At the end of the (trading) day, whether you're bull-ish or bear-ish, these are the underlying factors that simply won't go away. Understand them and market behavior over time may be a squinch more comprehensible.

Housekeeping item: we are changing our e-mail addresses. Please use [rick@ricktonge.com](mailto:rick@ricktonge.com) for me and [brenda@ricktonge.com](mailto:brenda@ricktonge.com) for Brenda.