The Tonge Telegraph
December 2006

That Blinking Yellow Light
A blinking yellow light on the road ahead heightens our awareness (if we pay attention) to the dangers we may confront at the upcoming intersection. The stock market has its own version of the blinking yellow light and it is now within view. Oddly, perhaps, the caution light is a product of success. Thus, it need not portend disaster any more than a yellow light and upcoming intersection mean we're about to have an accident. It should, however, focus our attention and lead us to proceed cautiously.

Let's review the success. The markets have had a nice run since June. We have passed through the normally treacherous months of September and October and are into the historically best months of the year for stock market gains, the November to May period. The Dow Industrial Average has, over the last 50 years, achieved almost 100% of its gains in those months. Hence the Wall Street saying "Sell in May and walk away."

So . . . the market has moved up, fitfully but with comforting consistency, over the last several months. The prospects for the economy and corporate earnings have stimulated hope; and, for the most part, results have fulfilled expectations. Today's economic report shows stronger growth than most people anticipated, but we still have a much slower pace than we had the first two quarters of the year. The predictions for next year are for a lower rate of growth in the economy than this year's. Housing starts continue to slump despite everyone's hope that the worst was over in that sector; and the Fed is worried about inflation. The tenor for next year will be set in part by how well retailers do this Christmas season. Signs—like the dip in Wal-Mart sales, for example—suggesting that the consumer is pulling back will send jitters through the financial markets.

The yellow light? Consider this: the current market rally began with my leading index reading just below 50%. Now that index is at 70%. A reading above 70% is not by itself unusual--it has happened 29 times since 1950. On the other hand, history reveals—blink blink—that when the index is at 70 or above, the time remaining in the rally may be limited. The longest time period this index has stayed above the 70% mark is 233 days. Since the average visiting time at that latitude is 103 days, we may surmise that the clock is ticking and the market will most likely have some sort of correction to lower levels in the coming months, coinciding with the expected slowing of the economy. No disaster at the crossroad, no cliff off which the market will plunge . . . we're simply motoring up to a view of reality: the way the market works.

Here's a thought: let's exercise some moderation this holiday season—spending, celebrating—and put in some time on our New Year's resolutions. That doesn't sound too Grinch-like, does it? Warm best wishes!

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